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ACCRUAL ACCOUNTING WITHIN GOVERNMENT-
WITH EMPHASIS ON THE DEPARTMENT
OF DEFENSE

by

Ronald M. Del Duca

ACCRUAL ACCOUNTING WITHIN GOVERNMENT—

WITH EMPHASIS ON THE

DEPARTMENT OF DEFENSE

by

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Degree of Master of Business Administration

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CHAPTER I

INTRODUCTION

Description of Problem and Background

The accrued concept of accounting recognizes expenses in the period in which they are incurred and revenues in the period in which they are earned. The essence of the accrual concept is that income arises from operating events that increase owner's equity, and only from such events. Any increase in owner's equity resulting from the operation of the business is called a revenue. Any decrease is called an expense. Income is the excess of revenues over expenses.¹ Accrued expenditures can be divided into two categories: (1) those documented by vouchers requesting partial payments or evidence of delivery, and (2) residual unbilled costs not yet documented by vouchers from the contractor.

The Report of the President's Commission on Budget Concepts issued in October 1967 recommended that the conversion of budget expenditures and revenues to an accrued basis be brought to early completion.² It further recommended that in

¹Robert N. Anthony, Management Accounting, Text and Cases (Homewood, Illinois: Richard D. Irwin, Inc., 1964), pp. 62-63.

²U.S., Executive Office of the President, Report of the President's Commission on Budget Concepts (Washington, D.C.: Government Printing Office, 1967), p. 7.

Accrual accounting has been a statutory standard since 1956. It has, however, been imperfectly achieved. In the defense establishment the concept is deemed necessary not only to abide by the law but to accomplish three basic purposes:

1. To provide current financial status information for day-to-day management purposes to all levels within the Department of Defense.
2. To provide financial data suitable for consolidation with other government agencies (e.g., the Department of Defense, which consolidates Army, Navy, and Air Force data for overall management purposes, and the Treasury Department, which consolidates data representing total Federal financial activity).
3. To collect and report financial data suitable for use in measuring budget performance at all levels of the departmental management, and by other interested government agencies and branches, such as Congress.

Purpose and Goals

The purpose of this thesis is five fold. First and foremost, the writer wants to gain as complete an understanding as possible in the area of accrual accounting because of the impact it has made and will continue to make upon the Department of Defense. Second, it is believed that this will be one of the first papers that, under the same cover, relates to accrual accounting from the viewpoints of Congress, the Executive Office of the President, the President's Commission on Budget Concept's, the General Accounting Office, the Department of Defense, and contractors associated with the military-industrial complex. Third, the writer will point out some of the problem

areas encountered in the Department of Defense while trying to implement accrual accounting. Fourth, the writer will illustrate how some of these problems have been solved, partially and fully. Fifth, the writer will make some general conclusions on the Navy's prospects of meeting the deadline for complete, "live," accrual accounting.

Methodology

This paper was written with data originating from many sources. The main sources of information and guidance came from Alvin Kamber, Office of the Navy Comptroller, and Commander L. Bruyneel, Fleet Resource Office, U.S. Atlantic Fleet; to both I owe profound gratitude. Interviews with sources in the Congress, the Department of Defense, the General Accounting Office, and various officials in the Department of the Navy were invaluable in that they provided a great deal of factual information and also added personal flavor to the study. The reports of the Interagency Study Group (Bureau of the Budget, General Accounting Office, Department of the Treasury, and the Department of Defense), Department of Defense Special Study Group on Constructive Delivery, and the Department of the Navy Financial Management Systems (Steering/Evaluation Group) were drawn upon throughout this paper.

Department of Defense and Department of the Navy directives in the area of accrual accounting were examined in depth. Interviews were held with the authors of most of the directives in order to gain further insight into their meanings and methods for implementing the accrual concept. "Off-the-record" feelings on the accrual concept were solicited from various agency and Congressional officials. It was interesting to

note that not all were firm proponents of the concept. However, their efforts to implement the concept as prescribed by law was enthusiastic, regardless of personal feelings.

Areas of Concentration

In developing this paper and analyzing the progress being made in the area of accrual accounting, the paper will devote a great deal of attention to the constructive delivery concept in the procurement appropriations. For obvious reasons, the paper will cover the problems encountered and progress being made in this area by the Navy. While all agencies of the Department of Defense (DOD) are confronted with this enigma, the Navy, by virtue of its commitments in land, sea, and air forces, has a many faceted problem to solve. The solution reduces itself to one common denominator—measurement of constructive delivery. Several measurement methods will be discussed and conclusions will be made upon the effectiveness of each. Conclusions will be made relating to the Navy's ability to successfully implement the accrual accounting concept in time for the budget preparation for Fiscal Year 1972. Finally, recommendations on how to satisfy accrual accounting needs will be offered for consideration.

CHAPTER II

ACCRUAL ACCOUNTING FRAMEWORK

Public Law 863

The concept of converting the government's accounts to the accrual basis is long standing. The second Hoover Commission proposed that agency budgets be presented in terms of annual accrued expenditures, defined as the charges incurred for goods and services received.¹ This recommendation was followed by an amendment to the Budget and Accounting Procedures Act of 1950. The amendment, Public Law 84-863 of 1956, states in part:

. . . as soon as practicable the head of each executive agency shall, in accordance with principles and standards prescribed by the Comptroller General, cause the accounts of such agency to be maintained on an accrual basis to show the resources, liabilities, and costs of operations of such agency with a view to facilitating the preparation of cost-based budgets²

Bureau of the Budget Circular No. 34 amplified P.L. 863 by introducing the concept of performance in determining when an accrual is valid. For example, a liability to

¹Jesse Burkhead, Government Budgeting (New York: John Wiley and Sons, Inc., 1956), p. 319.

²U.S., Congress, Senate, Amendments to the Budget and Accounting Procedures Act of 1950, Pub. L. 84-863, 84th Cong., 2d sess., 1956, S. R. 3897, p. 1.

pay heretofore was based upon receipts of goods and services by the payee or by acceptance at the place of manufacture or fabrication. Bureau of the Budget (BOB) Circular No. 34 stated that goods and services shall be considered received at the time title passes to the government, whether or not physically received.

Installation of accrual accounting systems as prescribed by P. L. 863 was to be under guidelines prescribed by the General Accounting Office (GAO). GAO has approved a number of agency systems to date and others are currently before the GAO for approval. The GAO affirms the definition of accrual accounting as spelled out by the Bureau of the Budget Circular No. 34. In specific terms, GAO prescribed the guidelines for the agency's accounting systems by defining constructive receipt of goods and services on a performance basis. A considerable amount of attention will be devoted to this concept later in the paper.

President's Commission on Budget Concepts

In the years subsequent to the passage of P. L. 863 and the issuance of BOB Circular No. 34, little, if any, progress was made in applying accrual accounting. Implementation of accrual accounting was slow because many in government questioned the value of accrual accounting. Now a new impetus is evident. This new impetus for accrual accounting stems from the recommendations of the report of the President's Commission on Budget Concepts. The major recommendation pertaining to accrual accounting that ". . . expenditures and receipts be reported on an accrual

basis instead of the present cash basis" gave added impetus to the 1950 and 1956 statutes. In its first reference to the term constructive delivery, the Commission stated that an expenditure should be accrued at ". . . the point in time at which the Government actually incurs a liability requiring immediate or eventual payment, including constructive delivery in the case of construction put in place and work performed by contractors on a specific order."³

The Commission's strong endorsement of accrual accounting, including constructive delivery, stems from three significant considerations. First, and of paramount importance, was the expressed need of the economists for better information on the economic impact of government spending. Second, the Commission considered the conversion to accrual accounting, including constructive delivery, as beneficial for the improved management of government resources. Third, the Commission recommended the government adopt the principles of accrual accounting, including constructive delivery, in order to bring the government's books more closely in line with the books of the private business community.⁴ Although not specifically mentioned, reading between the lines indicates that the Commission also wanted to preclude agencies from year-end juggling of funds that is possible under the cash basis.

³U.S. , Executive Office of the President, Report of the President's Commission on Budget Concepts (Washington, D.C.: Government Printing Office, 1967), pp. 7 and 37.

⁴U.S. , Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain G.E.R. Kinnear, director (Washington, D.C.: Department of the Navy, 1969), pp. 25-27.

Providing teeth to the President's Commission on Budget Concepts recommendations was President Nixon's letter to the Director, Bureau of the Budget, the Secretary of the Treasury, and the Chairman of the Council of Economic Advisers. Interestingly enough, two of these officials were members of the Commission. The letter reads in part:

. . . I hereby reaffirm the objective of placing our budget and financial reports on the accrual basis recommended by the President's Commission. Please continue vigorous joint effort with the Comptroller General of the United States to that end. I am expecting the heads of various departments and agencies to give their personal attention toward achieving this objective at the earliest practical date, so that the conversion can be made effective with the budget to be transmitted to Congress in January 1971.⁵

This is the budget for Fiscal Year 1972. As might be expected, this memorandum resulted in much correspondence of a personal nature between the President's chief fiscal advisers and the heads of departments and agencies. The Secretary of Defense was a recipient of a number of messages asking that he give his personal attention to the problem of establishing accrual accounting systems in the Department of Defense. He in turn advised the service secretaries. In short, things started happening!

Bureau of the Budget Bulletin 68-10

On April 26, 1968, Bureau of the Budget Bulletin No. 68-10, Reporting Accrued Revenues and Expenditures to the Treasury and the Bureau of the Budget, was issued.

⁵U.S., President, [Richard Nixon] "Memorandum for the Director of the Bureau of the Budget, The Secretary of the Treasury, The Chairman of the Council of Economic Advisers," Feb. 22, 1969, The White House, Washington, D.C.

It was the first government instruction to definitize the ground rules for recording and reporting expenditures on the basis of accruals and constructive delivery. It is considered the "charter," directing that all agencies proceed to implement accrual accounting principles. Some of the specific requirements relating to accrued expenditures are:⁶

1. Performance by the payee, through which he earns a payment from the Government, is the test to be applied.
2. The crucial point is the time when the money is first owed by the Government, as distinguished from the time when the money is legally "due and payable." Thus accrued expenditures include amounts equal to the liabilities for unbilled performance [emphasis added] by the payee, and the amounts of liabilities that have been billed to the Government.
3. The concept is applicable to amounts earned by subcontractors as well as prime contractors.
4. Monthly reports on an accrual basis should normally be obtained from major payees.
5. The "best estimate" will be used where the exact amount of accrued expenditures is not known and cannot feasibly be ascertained at the time the accrual should be recorded.

These requirements precipitated thousands of manhours of study and analysis in the Department of Defense. Further discussion of these point will be extensively covered later in this paper.

Treasury Departmental Transmittal Letter No. 18

On June 20, 1968, the Treasury Department issued Transmittal Letter No. 18 endorsing the framework, concepts, and definitions stated in BOB Bulletin No. 68-10.

⁶U.S., Executive Office of the President, Bureau of the Budget, Reporting Accrued Revenues and Expenditures to the Treasury and the Bureau of the Budget, Bulletin No. 68-10 (Washington, D.C.: Government Printing Office, 1968), pp. 3-5.

It confirmed that accrued expenditures should include the unbilled costs of contractors and grantees under the constructive delivery concept. Further, it provided instruction for monthly reporting to the Treasury in connection with a government-wide test of capability and progress toward implementation of the new accrual concept. Finally, the Treasury letter emphasized that if estimating expedients were used in deriving expenditure or revenue data, the reporting standards of credibility and sensitivity were essential and ". . . all reported data (1) should have a high degree of accuracy and (2) should be supported by the agency's accounting system."⁷

General Accounting Office

In mid-1969, the General Accounting Office issued an illustrative booklet entitled Accounting Procedures for Federal Agencies. This booklet discusses the procedures for accounting for accrued expenditures, including those based on constructive delivery. It enumerated possible methods of establishing the contractor's constructive delivery portion of accrued expenditures which are presented in abbreviated form below:⁸

1. In the case of fixed price contracts a statement from the contractor at the end of each month estimating the percentage completion including work performed by subcontractors could be used to estimate the accrued expenditure.

⁷U.S., Department of the Treasury, Treasury Fiscal Requirements Manual for Guidance of Departments and Agencies, Transmittal Letter No. 18, June 20, 1968, Washington, D.C., Attachment A, pp. 2 and 5.

⁸U.S., The Comptroller General of the United States, Accounting Procedures for Federal Agencies, Accounting for Accrued Expenditures (Washington, D.C.: Government Printing Office, 1969), p. 4.

2. If reports from contractors are not available, estimates could be obtained from project managers or other operating officials who are familiar with progress under the contract or grant.

3. Independent of or in combination with the foregoing ways, sampling and other statistical methods, could be used, especially where amounts are relatively small and the number of transactions is large.

While the GAO hinted at fully documented billing to satisfy the accrual concept, it is apparent that it realized that this amount of precision would be too laborious. Thus, the door is left ajar for the agencies to use mathematical or statistical analysis to compute accrued expenditures. Put another way, in the words of John B. Cooley, "Like misuse of penicillin, an overdose or misapplication of accrual accounting could do more harm than good."⁹ Put another way, benefits derived from precision reporting are outweighed by the costs involved.

The GAO also participated in an Interagency Study Group formed in conjunction with representatives from the Bureau of the Budget, Department of the Treasury, Department of Defense, Department of the Interior, Atomic Energy Commission, and the National Aeronautics and Space Administration. The purpose of this study group was to determine the best method for the recording and reporting of the amounts of unbilled performance of major contracts with private vendors. The work of the study group will be discussed in the next section of this chapter.

⁹John B. Cooley, "Unbilled Contractor Performance in Accounting for Accrued Expenditures—Some Practical Considerations," The Federal Accountant, Vol 18 (June 1969), p. 82.

Department of Defense

Mr. David Packard, then Deputy Secretary of Defense, advised the secretaries of the military departments and directors of defense agencies on March 3, 1968 that DOD would implement accrual accounting concepts as prescribed by the President's Commission on Budget Concepts. However, the Department later stated that accounting in DOD would be based solely upon documented transactions, and that accounting for unbilled work of contractors would not be undertaken. The procedures for this method were set forth in Department of Defense Instruction 7220.27. While this instruction deferred implementation of the constructive delivery basis of accounting and reporting, DOD recognized that to rely exclusively on contractor's reports would be too cumbersome. It would also abrogate the recommendation made by the President's Commission on Budget Concepts which was endorsed by the President.

Largely in response to DOD's reluctance to implement procedures to capture this unbilled performance, on April 4, 1968, an Interagency Study Group was formed. The Interagency Study Group first wanted to determine whether the amount of unbilled performance was material and if material, to recommend a practical method of measuring, recording, and reporting it.¹⁰ Between April and October 1968, the Interagency Study Group conducted an extensive review of constructive delivery in

¹⁰U.S. , Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain G.E.R. Kinnear, director (Washington, D.C. : Department of the Navy, 1969), p. 37.

DOD visiting ninety-two defense plants which represented operations of fifty out of the top 100 defense contractors. They determined that the unbilled performance was material. The Interagency Study Group further concluded that a contractor positive reporting system (precision reporting) would be impractical.

As a result of these finding, DOD recognized that a study group was needed to explore the feasibility of using statistical methods for obtaining these unbilled costs. The Navy was assigned primary responsibility for this effort and other DOD components were directed to assist as necessary. Thus, the Special Study Group on Defense Contractor Constructive Delivery was formed.

Concurrent with the formation of the Special Study Group, the Comptroller of the Navy undertook the task of developing a uniform chart of general ledger accounts to be used by all appropriations and funds. The purpose of this project was to uniformly classify, accumulate, and report similar transactions throughout the Navy. There are a number of advantages to be realized in the use of a single uniform accrual accounting system. Among these advantages are:¹¹

1. greater uniformity in classification of financial transactions;
2. greater uniformity in methods and procedures for accounting and reporting;
3. more complete disclosure of financial transactions and results;
4. greater facility in mechanizing accounting transactions and reporting;

¹¹U.S., Department of the Navy, Office of the Comptroller, Navy-Wide Uniform General Ledger Account Structure (NAVSO P-3064), March 7, 1969, Washington, D.C., pp. 2-5 and 2-6.

5. easier to understand the total system and each contributing subsystem;
and
6. greater control over design and administration of accounting system operations.

Need for Accrual Accounting

The foregoing sub-chapters described the "charter" of the accrual accounting concept and some of the background of its implementation. To make any system effective, top management must define the system, provide a blueprint for its execution and above all, pay it more than lip-service in support. From the President on down this has, for the most part been accomplished. But why do we need accrual accounting? What, if any, are the benefits of the system as envisioned by its proponents? The remainder of this chapter will be devoted to a discussion of the benefits of accrual accounting as determined by the President's Commission on Budget Concepts, certain bodies within Congress, the GAO, agency officials, and financial managers in the DOD.

Why do we need accrual accounting anyway? An interesting fact evolved from the hearings before the Sub-committee on Economy in Government (part of the Joint Economic Committee) while reviewing the report of the President's Commission on Budget Concepts. The economists pointed out that the budget for 1966, if it had been based on the definitions of the Commission, would have reflected at least two billion

dollars more in the way of expenditures in the DOD alone.¹² The accrual basis of accounting would provide more timely and accurate information for assessing the economic impact of the budget than either the Cash, Administrative, or National Income Accounts Budget.¹³

/ In the Consolidated Cash Budget, expenditures are stated on a checks-paid basis. In the Administrative Budget, expenditures are stated on a checks-issued basis. In the National Income Accounts Budget, expenditures are stated on different bases depending upon the nature of the transaction. For example: (1) expenditures for construction are stated on a put-in-place basis, somewhat equivalent to accrued expenditures; (2) expenditures for the procurement of long-lead-time items are on a completion and delivery basis; (3) interest expenditures are stated for the most part on an accrued basis; and (4) transfer payments, grants-in-aid and subsidies are stated on a checks-issued basis. Figure 1 is an example depicting some of the inadequacies of the systems in use today.

The example illustrates the inadequacy of the federal reporting and budgetary systems to provide timely information to the parties who are trying to plan the fiscal and monetary policies of the government. If for example, this information had been

¹²U.S., Congress, Joint Economic Committee, Review of the Report of the President's Commission on Budget Concepts, Joint Committee Print (Washington, D.C.: Government Printing Office, 1967), p. 26.

¹³U.S., Executive Office of the President, Report of the President's Commission on Budget Concepts (Washington, D.C.: Government Printing Office, 1967), p. 41.

Figure 1 — EXAMPLE TRANSACTION

				(million)	
1 July	Appro			\$ 2,000	
1 Sept	Contracts Let For Airframe			500	
30 Sept	Contractor Cost Incurred			40	
				Unpaid Contractor Bills	\$10
				Contractors' Prog. Pay Request	30
				Holdback (30%)	- 6
					<u>\$24</u>
<hr/>					
<u>CASH BASIS</u>			<u>ACCRUAL BASIS</u>		
9/1	Appro	\$2,000	9/1	Appro	\$2,000
	Oblig	500		Oblig	500
	Unoblig bal	<u>\$1,500</u>		Unoblig bal	<u>\$1,500</u>
9/30	Oblig Adj	\$ 500	9/30	Oblig Adj	\$ 500
	Cash Pymt	<u>24</u>		Unpaid bills	10
				Progress Pymt	24
				Holdback*	6
	Unliq Oblig	\$ 476		Unliq Oblig	<u>\$ 460</u>
Acctg Reports Cash Pymt			Acctg Reports Accrued Exp		
\$ 24			\$ 40		

A most significant problem today is in the area of procurement appropriations. This is an example of the appropriation for the procurement of aircraft, Navy, being \$2 billion. One contract would be let for airframes for \$500 million. The contractors have incurred costs of \$40 million as of September 30th. This \$40 million is made up of \$10 million of unpaid contractor bills somewhere in the system and a progress payment request for \$30 million. Subtract the holdback incident to that progress statement request because the contractor only receives \$24 million. The \$6 million is added back however, because it is part of the \$40 million even though the contractor does not receive it at this time.

*A predetermined percentage of money held back from the contractor until the contract is complete. This concept is normally used by the government to insure acceptable performance by the contractor.

Figure 1 — EXAMPLE TRANSACTION (Cont'd)

If on a cash basis of accounting, records would show that the appropriation was for \$2 billion, obligations were for \$500 million and an unobligated balance of \$1.5 billion remained in the appropriation. The \$500 million obligation would have been adjusted by the payment of \$24 million to the contractor, leaving an unliquidated obligation of \$476 million. The accounting reports coming in to the system would record only \$24 million.

There is a difference if on the accrual system. The records would agree through the unobligated balance of \$1,500 billion. However, as of 30 September unpaid bills would reflect \$10 million, progress payments would be \$24 million, and holdback would be \$6 million. The unliquidated obligation becomes \$460 million as compared to \$476 million under the cash basis. The accrued expenditure reports now reflect \$40 million instead of \$24 million as determined in using the cash basis.

From the above it is apparent that in using the cash basis, there is no evidence of work in progress in the contractor's plant. Not having this evidence in the accounting system, the program as of this time is understated by \$16 million.

available, the surtax might have been enacted one year earlier, or maybe other actions by the Federal Reserve Board would have been in order. The President's reaffirmation of the objective of placing the Federal budget and reporting system on an accrued basis for 1972 makes it imperative that accounting systems support the Federal budget. Summarizing the discourse above, it can be said that accrual accounting is needed to provide:¹⁴

- accrued expenditures reporting and timely data, indicative of government actions and their impact on the economy;
- full disclosure of results of financial operations;

¹⁴U.S., Department of the Navy, Financial Management Systems Steering/Evaluation Group, Report of the 30 July 1969 Meeting (Washington, D.C., 1969), p. 77.

- current financial and cost data that conforms to the period of performance in program management systems; and
 - adequate control over all assets, liabilities, and, investments of government.

The President's Commission discussed several benefits of the accrual accounting system. As mentioned above, a better index of the current impact of Federal financial activities on the economy is achieved. The system should also provide a better reflection of the financial condition of the government than any of the present timing concepts. As program costs are being increasingly used to measure agency performance, the accurate measurement of such costs is essential and accrual accounting will relate costs to the period of performance. Neither the obligation nor the cash basis of accounting provide this relationship. The adoption of the accrued expenditure measure would represent a further significant advance in improved internal management of individual Federal agencies. Most agencies are now or will be using costs for program management and agency control. The accrual concept for budget purposes will foster the concept of cost control in all agencies, and especially in those not now on a cost system.¹⁵

A goal of the Federal accounting system is the improvement of financial management practices throughout the government. A system that satisfied the management needs of both the executive and legislative branches, while meeting all legal requirements is sought. The accrual basis of accounting can contribute

¹⁵Ibid., p. 41.

materially to effective financial control over resources and costs of operations, and, is essential to the development of adequate and timely cost information. Establishing agency accounting systems on an accrual basis will serve fund and cost control needs and will include monetary property accounting as an integral part of the system. Additionally, the accrued system will provide more timely information than the cash basis of accounting, under which financial transactions are recorded in the accounts only when cash is received or disbursed. It will provide more timely information than the obligation basis, under which financial transactions are recorded in the accounts primarily when obligations are incurred.¹⁶

Tax liabilities are a much more important determinant of corporate spending and financial behavior than the cash payment of taxes. Since corporate profits and tax liabilities are exceptionally volatile, a time lag between accrual and payment of taxes of only a few months during an expansion or slump in the economy can produce sharp differences between the actual and apparent impact of corporation income taxes. Legislation requiring more current reporting and payment of taxes has reduced time lags between the accrual and payment of taxes. This same legislation actually operates to produce, during a period of speed-up, a sizable excess of cash over what otherwise would have been collected. Reporting corporation income taxes on an accrual basis during such periods (speed-up) will put the true yield of the corporation income tax in better perspective.¹⁷

¹⁶Ibid., p. 44.

¹⁷U.S., The Comptroller General of the United States, Accounting Principles and Standards for Federal Agencies (Washington, D.C.: The Government Printing Office, 1968), pp. 2-19.

Another major advantage of accrual accounting is that the government's records will parallel and match private business records to a closer degree. This is an important step in simplifying both national income and flow-of-funds accounting for the position of the government in an economy-wide framework. Moreover, it imputes a meaning to expenditures that is familiar to the public in relation to their own activities.¹⁸ While accrual accounting would be a long step forward in coordinating the timing of government and private accounting statistics and fitting them together, it will not be a perfect interlock because of variances in practice and the existence of mail floats (checks and invoices in the mail recorded by only one party). These problems would be small compared to those encountered presently.

Another reason for adopting the accrual system was the desirability of bringing closer together the official basis for reporting Federal budget expenditures and the basis used by the Department of Commerce in reporting on the Federal sector of the national income and product accounts. The President's Commission on Budget Concepts noted that a common basis would eliminate confusing discrepancies between the national income accounts estimates of Federal expenditures and the Federal budget itself.¹⁹

¹⁸U.S., Executive Office of the President, Staff Papers and Other Materials Reviewed by the President's Commission on Budget Concepts (Washington, D.C.: Government Printing Office, 1967), p. 200.

¹⁹Ellsworth H. Morse, Jr., "Reporting Budget Expenditures on the Accrual Basis," The Federal Accountant, XVI (December, 1967), p. 22.

CHAPTER III

CONGRESSIONAL POSITION ON ACCRUAL ACCOUNTING

Experience in the past has demonstrated that Congressional policy has a tremendous influence upon the plans and actions of the various agencies and in turn upon the public in general. Just the unofficial attitude of Congress has a bearing upon the action of an agency. Congress is not completely sold on all aspects of accrual accounting. Consider the time span between the Budget and Accounting Procedures Act of 1950 and its amendment Public Law 863 of 1956. Here, six years elapsed and no appreciable action was taken in implementing accrual accounting. Again, consider the time span between 1956 and the report of the President's Commission on Budget Concepts issued in 1967. Would a Congress, supporting a concept-made-law in 1956, allow it to not be implemented until some twelve years later? It is doubtful that if Presidents Johnson and Nixon had not endorsed the recommendations of the President's Commission on Budget Concepts, in particular the recommendation on accrual accounting, that the agencies would ever adhere to this law.

During the hearings preceding its enactment into law and since that time, the term accrual accounting has been controversial in Congress. Growing out of recommendations of the Second Hoover Commission, an effort was made to have

Congressional appropriations made on this basis rather than on an obligation basis. Public Law 85-759, approved August 25, 1958, provided that appropriations would continue to be made on the obligation basis but that each appropriation supported by a satisfactory system of accrual accounting could include a limitation on annual accrued expenditures. This procedure however, was never actually put into operation by the Congress and the act expired in 1962. Further, the President's Commission on Budget Concepts made it clear in their report that it was not suggesting any change in the basis on which Congress acts in authorizing expenditures through the appropriations process. The Commission's Report emphasized "its intent is not to alter the basis of Congressional expenditure authorization in any way."¹ Examining the membership of the Commission reveals some highly placed members of Congress. These members, no doubt, had a marked influence on the recommendations of the Commission. It could be that the Commission's Report was tempered by the views not only of those Congressmen on the Commission, but that these Congressmen also considered what their contemporaries in Congress "could live with." As might be expected, the Report of the Commission met with highly critical reaction, especially in the House Appropriations Committee. A source, who asked not to be identified, said that one of the main objections to the report stemmed from hurt feelings in Congress for various committee concurrence and as the writer has been led to believe, Congress regarded this as an affront.

¹Ellsworth H. Morse, Jr., "Reporting Budget Expenditures on the Accrual Basis," The Federal Accountant, XVI (December, 1967), p. 23.

The Congressional position on accrual accounting is best understood through examining various hearings and proceedings on the matter. There has been voluminous discourse on the subject in the Appropriations Committee, Government Operations Committee, and in the Joint Economic Committee.

Congressman George W. Andrews of Alabama from the Committee on Appropriations, discussed the accrual concept during hearings on the Legislative Branch Appropriation Bill, 1970. Interestingly enough, the Chairman of the House Appropriations Committee, Congressman George H. Mahon was a member of the President's Commission on Budget Concepts. The letter of transmittal accompanying the Commission's Report advises that "not every member of the Commission subscribes to each and every observation, premise, conclusion, or recommendation in the Report."² One may infer from the observations described below and later in the paper that Congressman Mahon was one member of the Commission who did not subscribe to the accrual concept.

Congressman Andrews attacks the accrual concept from many sides. His initial remarks referred to a statement made by the Honorable E.B. Staats, Comptroller General. Earlier, Staats, before a Subcommittee on Appropriations stated that more than 200 man-years of effort, about 10 per cent of the professional staff, would be applied to assist the Executive Departments in developing and approving accrual

²U. S. , Executive Office of the President, Report of the President's Commission on Budget Concepts (Washington, D.C. : Government Printing Office, 1967), p. VIII.

accounting systems.³ Andrews described this as "another area where there is some basis for saying that some of the manpower could more usefully be shifted elsewhere." Andrews continued by stating that P.L. 863 prescribed:⁴

. . . accrued accounting, not accrued expenditures budgeting. While accrual accounting was ordained some 13 years ago there has been considerable foot-dragging, apparently because there has been something less than enthusiastic reception or acceptance of all the claims made on its behalf. The Committee on Appropriations has never been enamored with the idea that accrual accounting and so-called cost-based budgeting are necessary or even desirable in many agencies of government.

Andrews further remarks that:

. . . there is no inherent virtue in uniformity; many operations where the variation between costs incurred [cost-budgeting, i.e., resources "used"] and obligations is not greatly different and of no appreciable significance to management in day-to-day decision-making or in the budgeting process.

Andrews apparently is referring to low cost, high usage "housekeeping items" for later he concedes that:

. . . the Committee agrees that in some agencies or programs with heavy inventory and contracting considerations accrued costs can be of significant use to management and review people in day to day operations and the formulation of budgetary requests.

Here Andrews is apparently referring to construction projects, weapons system contracts, etc. Andrews continues that:

. . . the current crash drive for accrued expenditure reporting comes primarily from the recommendation to change expenditures in the 1972 budget from a

³U.S., Congress, House, Committee on Appropriations, Legislative Branch Appropriations for 1970, Hearings, before a Subcommittee of the Committee on Appropriations, House of Representatives, 91st Cong., 1st sess., 1969, p. 541.

⁴U.S., Congress, House, Legislative Branch Appropriations Bill, 1970, Report No. 487 to accompany H.R. 13763, 91st Cong., 1st sess., 1969, pp. 32-34.

checks-issued basis to an accrual basis. A not inconsiderable part of the thrust for that stems from a desire to sophisticate budget and fiscal data for purposes of economic analysis. It is said that accrued expenditures will make the budget more useful for understanding the economic impact of the budget. That may be so to a limited segment of users of budget aggregates, but it is commitments, and contracts, and obligations that set the wheels in motion. Contractual obligations of the government—in whatever form, with whomever entered into—are the leading edge, the first binding administrative step on which subsequent actions take place. Congress authorizes and appropriates on the obligational authority basis. The President states his budget request on this basis. The grant of authority to obligate, and the act of committing and obligating that authority once it is granted, are from most angles the most significant decision points in the whole fiscal process.

The hearing continues with Mr. Andrews noting that when the 1956 accrual accounting bill was under consideration Congress went out of its way to avoid requiring the use of the accrued expenditure concept in the budget. From the standpoint of the House Appropriations Committee, Andrews said:

The Committee, in July 1956, expressed general approval of the cost—budgeting idea as to significant areas of operation. The Committee was, however, in opposition to the accrued expenditure idea. It saw defects then. It sees defects now.⁵

In respect to the law which mandates installation of accrual accounting across the Executive branch, the Committee feels that the law ought to be amended to make it discretionary rather than mandatory. It should be required in the areas meaningful to management and omitted where it makes no significant contribution but merely adds to the accounting workload. Andrews noted that: "Incidentally, Congress has not seen fit to extend the requirement to the legislative and judicial branches."⁶ Here of

⁵Ibid., p. 34.

⁶Ibid., p. 34.

course, the majority of expenditures are for personnel and travel where the accrual and cash concepts conform closely.

The House Appropriations Committee offers the view that Congress receives the budget requests, that Congress must consider these requests, and that Congress must act on these requests. Therefore, Congressional understanding must be the highest consideration. The accrual concept is not widely understood in Congress while nearly everyone understands what is meant by cash or checks issued. Hence, why try to confuse matters? The advocates of the Planning, Programming, and Budgeting system learned a very hard lesson from Congress while endeavoring to propose a budget based on programs. Congress does not look upon changes to old, established, proven principles too enthusiastically. Accordingly, Andrews concludes by saying:

. . . the Committee is taking steps to conduct an in-depth investigation and study into the whole question of the usefulness of accrual accounting as a government-wide requirement and of the relative accuracy and usefulness, and cost, of switching expenditure recording and reporting systems to the accrued basis. In the meantime the Committee thinks the crash drive toward government-wide application ought to be suspended.⁷

The criticisms of accrual accounting discussed above by Congressman Andrews drew a round of fire from Congressman Monogan of the House Committee on Government Operations. Congressman Monogan, speaking before the full House on September 19, 1969, took sharp exception with the remarks made by Congressman Andrews. First he stated there was a very marked difference of opinion as to the

⁷Ibid., p. 35.

views that are expressed in the House concerning the value of accrual accounting.

Monogan then pointed out that the Appropriations Committee acted out of their jurisdiction when they assailed the accrual concept. He states:

I would like to point out that this [accrual accounting] is a matter that is within the jurisdiction of the House Committee on Government Operations. The Comptroller General has very specific and definite opinions on this question and supports the Government Operations Committee position. The Committee on Government Operations has jurisdiction over budget and accounting measures other than appropriations and has the duty of receiving, studying, and reporting to the House on reports of the Comptroller General. The law also requires the Committee to exercise legislative oversight jurisdiction over the Comptroller General and the General Accounting Office. The Committee has taken these responsibilities and duties very seriously. Consequently, many members of the Committee were very much concerned to read the discussion of the General Accounting Office activities and of accrual accounting in the legislative branch hearings on the appropriation bill [referring to the remarks of Congressman Andrews above]. It is obvious that the members of the Appropriations Committee are not entirely satisfied with the virtues of the accrual accounting systems now prescribed by law for Federal agencies. This, of course, is a matter clearly within the jurisdiction of the Committee on Government Operations.⁸

The jurisdictional dispute apparently had added impact because the views toward accrual accounting held by these Committees were almost entirely opposite.

Congressman Holifield of California added:

With all due respect to the great Committee on Appropriations I would like to remind the gentlemen in charge of the bill [Appropriations Bill for 1970] that its committee is stepping out of its bounds. I recognize that the Committee on Appropriations has a proper interest in Government accounting. At the same time this matter has a long history of development and seems to be the accepted basis for improvement in the Government accounting programs. This [accrual accounting] is the present system of accounting, and it is a well recognized system of accounting. It is not anything new. It has been approved by the American Association of Accountants for many, many years. I would hope the Committee on

⁸U.S., Congress, House, Chairman Monogan speaking for the Government Operations Committee on Accrual Accounting, Sept. 19, 1969, Congressional Record, Vol. 115, H8218.

Appropriations would go slow on this matter. I do not know where this interest arose on their part, but if they feel there is a need for hearings, I can assure them we will have hearings in the Government Operations subcommittee that is charged with this responsibility and we will listen to the presentations of those who favor both accrual accounting and the regular accounting procedures that they now use.⁹

Further contrast concerning the views of Congressional members on accrual accounting is seen in hearings before the Subcommittee on Economy in Government of the Joint Economic Committee. Secretary of the Treasury, David M. Kennedy, testifying before this subcommittee, emphasized that a budget utilizing the accrual concept would reflect current economic conditions more readily and precisely than a budget prepared as a result of the cash or checks-issued concepts. To which Chairman Proxmire replied:

Let me just say, in talking with members of the staff, it is their view that this budget will do a better job than ever the NIA budget in reflecting the effect of Government spending and taxing on the economy. This is very significant it seems to me. And I trust their judgement.¹⁰

The Honorable Elmer B. Staats was a witness during a hearing before a subcommittee of the Committee on Appropriations in July 1969. Congressman Andrews of Alabama chaired this hearing. The purpose of the hearing was to discuss accrual accounting and to obtain the Comptroller General's opinions on it. Mr. Staats advised Chairman Andrews that one of the recommendations that came out of the work of the President's Commission on Budget Concepts was to place all estimates of government

⁹Ibid., p. H8222.

¹⁰U.S., Congress, Joint Economic Committee, Review of the Report of the President's Commission on Budget Concepts, Joint Committee Print (Washington, D.C.: Government Printing Office, 1967), p. 26.

expenditures on a common basis. That is, for the Treasury's reporting of expenditures, for the Commerce Department's estimates of what the government's part of the national income and gross national product represents, and for the purposes of budget estimates—these would all be based on accrual accounting, accrued expenditures. Mr. Staats further testified that the Budget Bureau, the Treasury, and GAO all concurred that the accrual concept was necessary. The problem before GAO was to get accrual accounting installed first where it is important in terms of the actual expenditures reported in the budget—the contract area particularly. Significantly, Mr. Staats pointed out that another reason GAO was devoting so many manhours in this area was that they felt it was necessary because of the continuing heavy criticism they (GAO) were getting from different parts of the Congress for not carrying out this 1950 legislation. Mr. Staats further testified that the President's endorsement of the concept will be a big help in getting the agencies to give enough attention to this area.¹¹

Congressman Andrews stated that he understood that accounting and reporting expenditures on the accrual basis will be a more elaborate and more costly system than the present cash or checks-issued basis. Also, according to Andrews, most people understand the old-fashioned cash and checks-issued basis, most people are not accountants and would not understand the accrual concept. Congressman Andrews then got to the point:

¹¹U.S. , Congress, House, Committee on Appropriations, Legislative Branch Appropriations for 1970, Hearings, before a Subcommittee of the Committee on Appropriations, House of Representatives, 91st Cong., 1st sess., 1969, pp. 568-569.

As I think you know, Mr. Staats, there are some around the Committee who have reservations about the claimed superiority of the accrued basis of reporting expenditures over the present checks-issued basis insofar as budget presentation purposes are concerned. While the Budget Concepts Commission included membership from the Legislative Branch, including two members of this Committee, and there was unanimity on the idea of a unified budget concept to replace the three separate concepts of Administrative Budget, Cash Budget, and National Income Accounts Budget, I am advised that there was not necessarily complete agreement on the question of stating or presenting the expenditures side of the budget on an accrued expenditure basis.¹²

Congressman Andrews reiterated that it has been thirteen years since the Congress wrote into law that all agencies should adopt this system and wanted to know if there was any basis for this foot-dragging. Mr. Staats agreed that up until three years ago there was some foot-dragging. Then a number of steps were taken to move forward:¹³

1. President Johnson directed agency heads to exert additional influence in getting more manpower and higher priorities on this work.
2. GAO placed additional emphasis on this area of assigning more manpower to financial management work.
3. GAO revised their procedures for approving agency accounting systems in such a way it speeded up the process.
4. Meetings were held with agencies to work with them in resolving problems they had.
5. Hearings were held by the Government Operations Committee which focused on the need for additional effort in the development of accounting systems.

¹²Ibid., p. 659.

¹³Ibid., p. 661.

As the hearing continued, Congressman Andrews dwelled on the question of superiority and expressed doubts that stating the budget on the accrued expenditure concept was superior. He noted:¹⁴

Back in 1956, when accrual accounting was written into law, I am advised that Congress specifically did not order or specify, or even contemplate that, just because a concept of accrued accounting was being written into law that it would necessarily follow that the expenditures in the annual budget would be stated on that basis. I am sure you will recall later, in 1958, under a law that arose out of the Hoover Commission recommendations, there was a short-lived trial basis on certain appropriations where the accrued expenditure appropriation concept was sought to be applied and very little happened and it expired. I imagine it is accurate to say that not only has Congress never specifically done anything which mandated that the Federal budget be stated on accrued expenditure basis but on the contrary, in a sense, it specifically left that decision to the future.

You also said, of course, that one of the arguments of the economic community before the Commission was to adopt a single concept, or words to that effect. The checks-issued basis is a single concept. It is one they perhaps did not like as well or it was not as suitable for them, perhaps not sophisticated enough. It is a matter perhaps of first considerations first. Who are the main users of the budget? It seems fair to say that the Congress is the first user. The budget is submitted to Congress, and the Congress has to consider it, study it, deal with it, and therefore, accuracy and ease of understanding are high considerations.

As promised by the Committee on Appropriations, an investigation will be made on the usefulness of switching to the accrual basis of accounting. This, even after the word of caution to go slow issued by Congressman Holifield of the Government Operations Committee to the House Appropriations Committee. In a letter dated November 6, 1969 to the Secretary of Defense, Mr. Paul J. Mohr, Director of Surveys and Investigations, House Appropriations Committee, advises that an in-depth investigation and study into the whole question of the usefulness of accrual accounting will be made in the defense department. The investigation will also determine the

¹⁴Ibid., pp. 663-666.

relative accuracy and usefulness and cost of switching expenditure recording and reporting systems from the checks-issued to the accrual basis.¹⁵ With approximately 40 per cent of the total budget going to defense, what better place to investigate? To date, no information on the status of this investigation is known to the writer.

The position on accrual accounting in Congress is not settled. One obvious observation is that unanimity has not been reached. Only after accrual accounting has been fully adopted in the Executive Branch and experience is gained in Congress in dealing with it can a fair evaluation be made. In the meantime, Congress will continue to hassle over the merits and demerits of the system. So stated by a staff director of the House Appropriations Committee, "accrued accounting is fine, but accrual expenditures for budgeting is not."¹⁶

¹⁵U.S., Congress, House, Letter from Director, Surveys and Investigations, House Appropriations Committee, November 6, 1969, Washington, D.C.

¹⁶Paul M. Wilson, Assistant Clerk and Staff Director, Committee on Appropriations, private interview held in House of Representatives, November 17, 1969.

CHAPTER IV

DEPARTMENT OF DEFENSE POSITION ON ACCRUAL ACCOUNTING

Background

The Department of Defense implemented a program designed to provide managers better cost data and cost control, closely related to the accrued expenditure concept in that they both require adequate accrual accounting for success. The program, called Project PRIME (originally acronym meaning Priority Resources Improvement Management Effort, currently PRiority Management Effort), has the objective of establishing monetary and quantitative controls. This will enable management to determine effectiveness in terms of total resources applied to the cost of operation of an organizational entity. It is another development to bring about a closer tie between programming, budgeting, and accounting.

PRIME was to be implemented on July 1, 1967 in the Department of Defense. However, on June 9, 1967, in Report No. 349, the House Committee on Appropriations expressed its opposition to PRIME and negated much of the effort by taking the following action.¹

¹U.S., Department of the Navy, Office of the Comptroller, Resources Management Systems Bulletin Number Four (NAVSO P-3038), May 27, 1968, Washington, D.C., p. ii.

- Directing no change in the DOD budgeting and accounting system preparatory to the formulation of the Fiscal Year 1969 budget presentation; and
- Deleting funds for required civilian personnel augmentation.

In his memorandum of June 30, 1967, the Assistant Secretary of Defense (Comptroller) said that as a result of the Committee's report, it was necessary to reconvert and reschedule Project PRIME.

On July 1, 1968 the Department of Defense commenced operations under Project PRIME. In describing PRIME, it will be viewed in terms of the deficiencies it corrected. Procedures used prior to this time were deficient in that they did not provide comparability and complete information. For example, procedures in use did not allow tracing of specific dollar amounts from initial programs, through the budget, to organizational units charged with execution of the program. Also, these same procedures contained basic inconsistencies in the way the services aggregated similar costs. There were many such inconsistencies with obvious consequences for viewing totality of operations in the Department of Defense. These inconsistencies created three problems:

1. No assurance operating budget reflected total program. Budgets were expressed in terms of "raw material". . . programs expressed in terms of "finished product."
2. No assurance actual expenses were consistent with planned expenses. Accounting systems not on same "wave length" as program.

3. No assurance resources were compatible with changing missions.

Additional responsibilities assigned without associated resources.

As mentioned above, previous systems provided incomplete information in that:

1. Total costs were not collected by organizational units. Much labor and materiel were seen as "no cost" by users and the operating manager was not aware of resources used.
2. There was a lack of motivation for total resource management. Managers were not given adequate management information pertaining to resources they received on a "no cost" basis.
3. Planning data was inadequate. Operating experience was artificially converted back into program terms.

But, most important, the systems in use did not provide for accrual accounting in accordance with statutory requirements.

Project PRIME was designed to make financial management of operations consistent with the Five-Year Defense Program. PRIME just did not fall together. Many people from all areas and levels of management were involved in the details to insure the end result was a usable program. Both the General Accounting Office and the Bureau of the Budget provided substantial counsel during development and testing phases. Testing has been accomplished by all the services and has demonstrated PRIME to be a success. Tests have shown that as managers become more cognizant

of actual operating costs being reported against programs, they resorted to more precise planning for the efficient use of the resources furnished.

Department of Defense Instruction 7220.27 of July 8, 1968 was issued to provide guidelines for accounting for accrued expenditures and revenues as required by the Budget and Accounting Procedures Act of 1950 as amended by Public Law 863. The immediate charter in the chain of events for DOD Instruction 7220.27 was the Bureau of the Budget Bulletin 61-10. However, it does not provide for the use of constructive delivery concepts as set forth in BOB Bulletin 68-10. DOD first wanted to determine the materiality and practicability of these concepts before implementing them throughout the defense establishment.

The DOD Instruction provides for the recording of accrued expenditures based solely upon documented transactions and reads in part:

Accrued expenditures and revenues will be recorded in the accounts on the basis of documentary evidence, including administratively prepared documents where such documents are ordinarily used in accordance with accepted accounting practices.²

For contractual services and material, accrued expenditures are to be recorded on the basis of a receiving report or a billing document, whichever document is first received.

The only exception to this rule applies to contracts authorizing progress payments based upon performance accomplished in advance of receipt of the goods or services by the government. For these contracts, the amount of accrued expenditures

²U.S., Department of Defense, Accounting for Accrued Expenditures and Revenues (Department of Defense Instruction 7220.27), July 8, 1968, Washington, D.C., p. 2.

is based on a Contractor's Request for Progress Payment (DD Form 1195) or an equivalent instrument. Where appropriate, related fees earned by the contractors are included in the accrued expenditures. The amount recorded as accrued expenditures therefore is the sum of progress payments and the amount of related holdbacks.

As demonstrated, the accrued expenditures concept in defense for contractual services and materiel is based solely upon documented transactions and does not include the amount of unbilled performance by contractors.³ This is commonly referred to as the "document-on-hand" concept.

The General Accounting Office approved DOD Instruction 7220.27 in theory, however, the implementation plans of this instruction have not been submitted to the GAO for approval. Both DOD and GAO are in the field; DOD testing the concepts of 7220.27 and GAO auditing the tests. Testing and auditing the practical aspects of 7220.27 is a continuous program and will continue until July 1, 1970 or longer.⁴ GAO will audit the system officially after it is in operation and only after DOD requests an audit. In the meantime GAO is acting as an advisory group as requested by DOD. On October 9, 1969, GAO set up an Accounting Systems Review Group whose responsibility is to audit systems upon request from DOD. These audits are unofficial and are

³Interagency Study Group, Report of the Interagency Study Group on Contractor Reporting for Purposes of Federal Accounting and Reporting of Accrued Expenditures (Washington, D.C., 1968), p. 60.

⁴Paul E. Lynch, Supervising Auditor, Accounting Review Group, Defense Division, General Accounting Office, private interview held in the Pentagon, November 24, 1969.

conducted by GAO in accordance with the principles of each system as set forth by DOD. Both during and upon completion of the audits, GAO makes recommendations as necessary.

As pointed out in Chapter II, the Interagency Study Group determined that unbilled contractor performance was material and that a positive (precision) system of collecting the charges was impractical. This presented DOD with a problem—how should the charges be compiled? The Navy was given primary responsibility in solving this problem. Progress in this area will be discussed later in the chapter.

Problems Facing the Department of Defense

In time, the DOD accrual accounting system will be successfully implemented. There are some problems that must be encountered and solved, however, There are problems both internally in DOD and externally between DOD and the civilian contractors. These areas are discussed below.

In reporting to major commands the Army normally allows eight working days; the Navy twelve calendar days; and the Air Force seven to ten calendar days. Also involved, frequently are intermediate consolidation points through which reports must flow prior to reaching the major command levels. These reporting dates represent a tremendous coordination problem at the top of the DOD hierarchy. The reporting dates will have to be coordinated in order for defense to report to Treasury by the determined monthly reporting date. To illustrate the magnitude of this problem, the following

information was obtained from the Defense Contract Administrative Services Regions (DCASR's). The eleven DCASR's hold a total of 66,395 unpaid invoices on hand as of July 31, 1968, with the number of invoices for individual offices ranging from 2,685 to 10,287. In addition, a substantial number of receiving reports were on hand without invoices. Distribution of the amounts by appropriation would be required prior to preparing an Accrued Expenditure Report. Further, the stringent reporting deadlines may preclude the reporting of receiving reports in transit at month-end to the DCASR's from other military installations.⁵ To further compound the problem, the invoices and receiving reports must be identified and stratified by appropriations at the Navy Regional Finance Centers and disbursing offices of all the services. This is assuming that the billings will be submitted on a timely basis and that billings consider all types of costs incurred. Deviations at these points complicates the problem further.

Services are not applying the concept of accrual accounting uniformly. For example, the Air Force simultaneously obligates and expends all contracts of \$5000 or less. This does fit the accrual principle in that performance by the contractor does not have to occur. With a contract of this size an accrual would most likely occur within the fiscal year if not placed too near the end of the year. But suppose the contract was placed in May or June. Would the accrual occur prior to the end of the year as assumed or would it occur in July or August after the new fiscal year has started? One could argue that the materiality concept would apply here and that a

⁵Ibid., pp. 63-64.

contract of \$5000 would have no significance overall. How about 10,000 such contracts?

A major problem in the accounting for accrued expenditures in the procurement appropriations is the lack of standardizations. The systems currently in effect range from the Air Force's highly computerized system which can account for individual invoices as soon as they enter the accounting process, to the Navy's manual system which uses an estimating system to determine the value of documents on hand at the end of the accounting period which have not been paid.

There is variance in the method of determining the holdback which is to be reported as an accrued expenditure. The Navy and Defense Supply Agency estimate holdback as one-third the unliquidated progress payments. The Army has no specific method but permits the individual command to determine their own method. The Air Force computes the holdback percentage separately for each contract.⁶

Computation of fees and profits need to be resolved. At present, none of the DOD components has established a system to compute the fees and profits which should be reported as an accrued expenditure for applicable contracts under the procurement appropriations.⁷

As mentioned earlier in the chapter, an Accrued Expenditure Report is prepared by the DCASR's. Not infrequently, this report duplicates financial data already in the books of the responsible DOD agency. This occurs where the agency is accruing the expenditure on the basis of inspection or receiving reports and the DCASR is reporting

⁶Ibid., p. 167.

⁷Ibid., p. 167.

a gross accrued expenditure figure that includes the related invoice for the same items. Since the Accrued Expenditure Report reflects gross dollars by appropriation, there is no backup detail to enable the defense agency to reconcile the total with his accounting records. Even if such detail were furnished, the necessary detail information about procurement accrued expenditures for the defense agency is not available at the level to which the report is sent.⁸

Another major problem can be referred to as the "iceberg"⁹ problem which is undocumented, unbilled performance. This problem exists at both the prime contract and subcontract level when performance occurs but is not recorded in the books. Hence the government is not aware of the costs incurred. The Interagency Study Group investigated the "iceberg" problem and came up with some significant findings. Of seventy-two contractors' plants only two had unbilled performance data of subcontractor's available without any qualification. Fifty plants had data available with some qualification; the major qualification being that they did not have subcontractors' costs. Five plants stated that cost data was partially available and fifteen plants emphatically stated that such cost data was not available. Some explanations for these conditions are that work in-process and material inventory could

⁸U. S. , Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain G. E. R. Kinnear, director (Washington, D. C. : Department of the Navy, 1969), p. 166.

⁹U. S. , Department of the Navy, Office of the Comptroller, "Memorandum for the Record, May 6, 1969," Washington, D. C. , p. 3.

not be identified to government contracts. Also costs for firm fixed-price contracts were not segregated. Since about \$15.5 billion, or 40 per cent of the total prime contract value in fiscal year 1967 was subcontracted, unbilled subcontractor performance is significant. Obtaining this information in the future will present a problem based upon sheer volume of subcontractors and subcontracts. Twenty-one of the plants visited by the Interagency Study Group provided the statistics shown below.¹⁰

<u>Number of Subcontractors</u>	<u>Number of Plants</u>
1-50	4
51-100	5
101-500	0
501-1000	4
1001-2000	1
2001-3000	1
3001-4000	2
4001-5000	2
5001-10,000	1
over 10,000	<u>1</u>
Total	21

Prime contractors also contribute to the "iceberg" problem. Significant dollar amounts are not disclosed in a timely manner to the military disbursing offices in the normal course of the billing and disbursing process. Examples are:¹¹

1. costs incurred for firm fixed-price contracts for which billing will be made only upon completion of the contract;

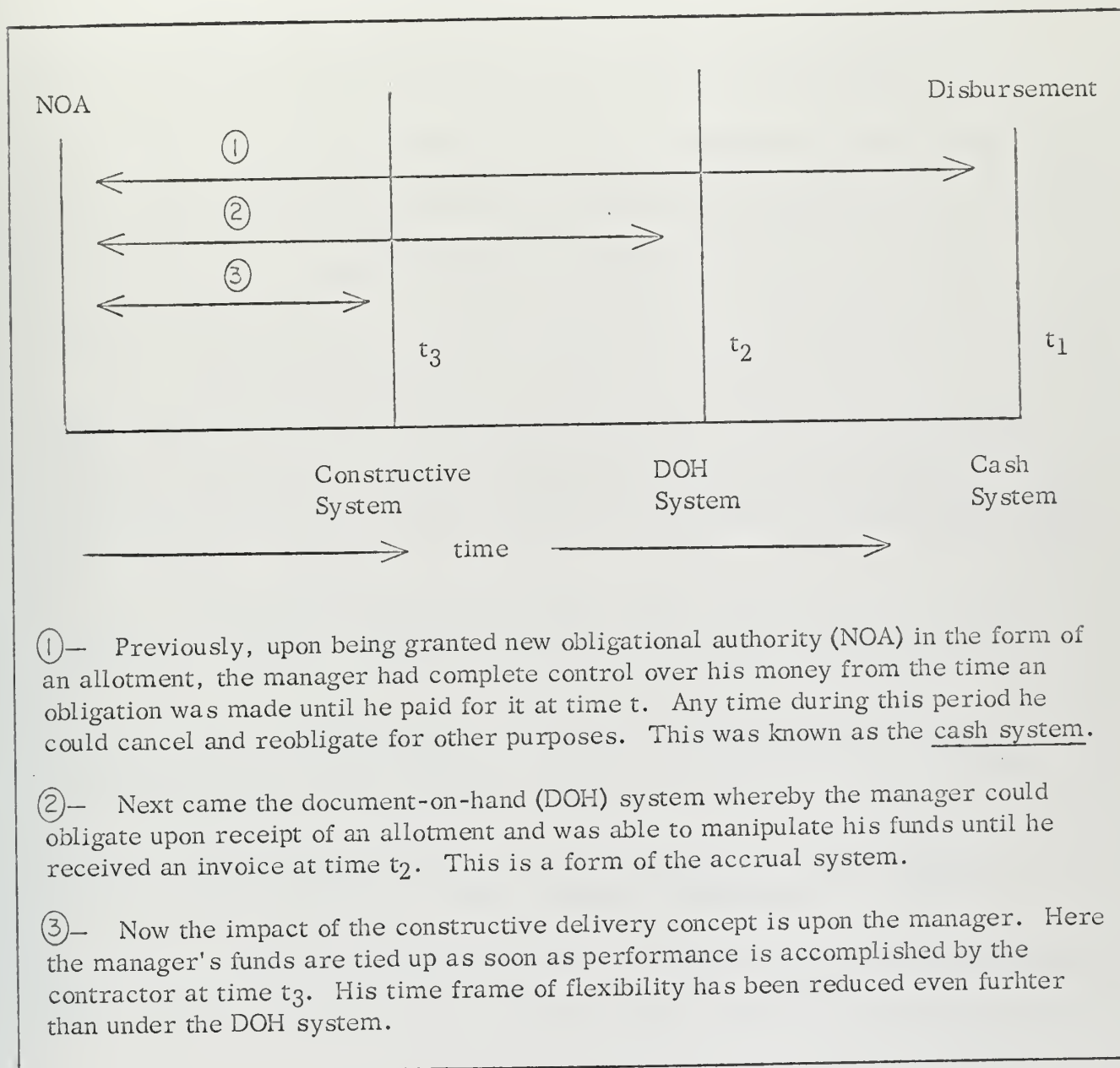
¹⁰Interagency Study Group, Report of the Interagency Study Group on Contractor Reporting for Purposes of Federal Accounting and Reporting of Accrued Expenditures (Washington, D.C., 1968), pp. 47-53.

¹¹Ibid., pp. 48-49.

2. overhead costs awaiting settlement or overhead costs incurred on cost-type contracts above the provisional overhead billing rates which may be adjusted upwards by subsequent audits;
3. the value of unbilled performance included in work-in-process inventory not identified by contract;
4. costs incurred on shipments made under contractual agreements for which prices have not been definitized;
5. costs incurred prior to partial delivery billings for fixed-price contracts without progress payments;
6. costs incurred in excess of the prices agreed upon but subject to subsequent billings based upon price-index fluctuations under escalation clauses; and
7. costs incurred on contracts providing for attainment of certain milestones before billing is permitted.

There are several other problems within the DOD that must be solved in order to accomplish the accrual concept. While not as great as the problems discussed on the preceding pages, they must be solved. First, to collect, record, and report all the data there will be additional costs in terms of personnel and accounting equipment. Second, from a behavioralist standpoint, some motivation of managers will be required. The discerning manager, reflecting back over his career can see a definite trend in the removal of his authority. Figure 2 depicts the various phases a military manager has experienced relative to his authority in making financial decisions.

Figure 2 — AUTHORITY PHASES FOR THE MILITARY MANAGER



In ② and ③ of Figure 2, the reduction of the manager's prerogative is apparent. Recognizing that this can be a demoralizing influence upon the military manager, DOD must take steps to adequately "sell" the system.

What problems will the contractors who do business with DOD face? Will they be willing to adopt accounting systems that will satisfy the requirements of the precision constructive delivery method? A discussion of these problems follows.

The National Security Industrial Association in sampling a cross-section of the views of their membership stated that the requirements of BOB Bulletin 68-10 goes far beyond the normal concept of accrual accounting. A review of one division of one major manufacturer in the aerospace and defense group disclosed the following:¹²

1. Regarding the possible requirement of reporting unbilled performance data by each contract, the division receives about 10,000 purchase orders per year from all contracting tiers. Active at any one time are approximately 6,000 - 7,000 purchase orders. To carry out Bulletin 68-10 requirements to this level could possibly necessitate reporting unbilled performance on 6,000 - 7,000 purchase orders per month.
2. The division issues some 70,000 purchase orders per year to approximately 4,500 vendors. Approximately 75 percent of these vendors would be unwilling or unable to provide the type of unbilled performance required.
3. Almost without exception, information required from subcontractors could not be made available regardless of the costs involved, unless all of the accounting systems were completely redone.
4. The reporting period that the government desires is one month; the division reviewed operates on a four-week accounting period.

Bear in mind that the preceding applies to but one division of one major aerospace and defense contractor. It would not be unusual for such a contractor to have five or more such divisions.

¹²National Security Industrial Association, letter to Director, Bureau of the Budget, Dec. 26, 1968, Washington, D.C., pp. 1-2.

The National Security Industrial Association also pointed out that contractors do not normally evaluate contract work-in-process against selling price on a line item basis as would be necessary operating under the rules of Bulletin 68-10. Furthermore, contractors are not normally concerned with the allocation of their contract costs by appropriation numbers. Major government contracts often have as many as thirty different appropriations cited and if such a contract had 200 line items, the number of calculations on that contract could be equivalent of 6,000 status reports of the type proposed.¹³

The Interagency Study Group sampled thirty contractors' plants to determine how long it would take to implement a special reporting system in an effort to capture some of the "iceberg" costs discussed earlier. Each of the thirty plants made estimates based upon their own interpretation as to the potential reporting requirements and criteria. Their replies are summarized below:¹⁴

<u>Implementation Time</u>	<u>Number of Plants</u>
1 month	4
3 months	6
6 months	9
12 months	8
18 months	2
24 months	<u>1</u>
Total	30

¹³Ibid., p. 3.

¹⁴Interagency Study Group, Report of the Interagency Study Group on Contractor Reporting for Purposes of Federal Accounting and Reporting of Accrued Expenditures (Washington, D.C., 1968), p. 57.

As in the case of implementation time, costs could not be accurately estimated without more specifics as to reporting requirements and criteria. The costs varied among the contractors depending upon the degree of refinements needed to existing accounting systems and the due dates for the monthly reports. Some estimates are:¹⁵

1. \$32,000 annually;
2. Initial conversion, \$2.7 million; \$1 million annually;
3. \$180,000 for ADP reprogramming only;
4. \$500 per contract month; and
5. \$350,000 first year, \$225,000 annually.

The Interagency Study Group also sampled seventy-three contractors to acquire a "feel" for sheer volume of reports if the precision reporting system is imposed. As pointed out by the National Security Industrial Association in their study, the number of reports would be massive. These data are summarized in the following schedule:¹⁶

<u>Number of Contracts</u>	<u>Number of Plants</u>
1-25	13
26-50	9
51-100	9
101-250	19
251-500	11
501-750	5
751-1000	2
1001-1500	3
Over 1500	2
Total	<u>73</u>

With each contract covering between 1000 to 5000 purchase orders, the volume of monthly reporting would be astronomical.

¹⁵Ibid., p. 57.

¹⁶Ibid., p. 58.

The reaction of most contractors, upon realizing the necessity of revising their accounting systems in order to enact the proposed reporting requirements has been, "Who is going to pay for it?" Naturally they feel that the government should bear this cost. One contractor, a minor one at that, felt that processing constructive delivery reporting would cause him to generate in excess of 800,000 reports monthly. In order to do this, he estimated he would increase the face value of the contract by 1 per cent at the minimum.¹⁷

To say the least, there are a multitude of problems facing DOD in the implementation of accrual accounting. What is being done to overcome these problems?

Progress in the Department of Defense

The Assistant Secretary of Defense (Comptroller) Robert C. Moot directed the Assistant Secretary of the Navy (Financial Management) Charles A Bowsheer, to conduct a test of the constructive delivery concept of accounting for accrued expenditures on December 4, 1968. The test, requested by the General Accounting Office, through the Secretary of Defense, was to be conducted for the DOD by the Navy.

¹⁷LTJG K.L. Lay, SC, USNR, Deputy Director (Research) DOD Special Study Group on Defense Contractor Constructive Delivery, private interview held in Washington, November 25, 1969.

The parameters of the test established by the Secretary of Defense were a:¹⁸

- small but representative sample of contractors and contracts involving major appropriations and variety in type of contracts;
- single or limited number of accounting offices;
- limited number of disbursing offices;
- separate report for each contract of accrued costs by line item; and
- test period to be 1 March through 30 June 1969.

Twelve contractors were selected involving seventy-five contracts, and having an aggregate dollar value of \$1.63 billion. All contracts were active, complex in relation to reporting requirements, and, of different types, such as cost and fixed price. Each contractor was requested to make one report per month per contract over the four month test. A Report of Costs Incurred was to be returned to the contract administration office within five calendar days after the end of the month reported. Contract administration offices were then to forward the reports to the Comptroller of the Navy.

Contractors were advised that all costs, including those normally unbilled until the completion of a contract were to be recorded. These were to include costs incurred applicable to work in process, inventories acquired solely for specific government contracts, costs of unbilled subcontractor performance, profits, fees,

¹⁸U.S., Department of the Navy, Office of the Assistant Secretary of the Navy (Financial Management), "Memorandum for the Assistant Secretary of Defense (Comptroller)," March 3, 1969, Washington, D.C.

and any other costs incurred specifically for government work. For fixed-price contracts expenditures reported were to be based upon stage of completion. Forms were provided to record all these costs.

The test never got off the ground. The contractors, represented by the National Security Industrial Association, balked at this positive, precision system.¹⁹ The test, even though it never was initiated, was beneficial. It precipitated DOD's studies into the areas of constructive delivery through statistical means and the document-on-hand system. The remainder of this chapter will be devoted to examining DOD's progress in these areas.

The Interagency Study Group, chartered to perform a study on the various ways of applying the accrual concepts, determined that a major problem was the recording and reporting of unbilled performance of major defense contracts with private enterprise. Accordingly, the Interagency Study Group recommended that the Department of Defense begin to explore a statistical approach or a mathematical model for estimating the amounts of unbilled performance.²⁰

In April 1969, under the sponsorship of the Assistant Secretary of the Navy (Financial Management), the DOD Special Study Group on Defense Contractor Constructive Delivery (Accrual Accounting Implementation) was formed. The Study was comprised of representatives from the Air Force, Army, Navy, Defense Supply

¹⁹National Security Industrial Association, letter to Director, Bureau of the Budget, December 26, 1968, Washington, D.C.

²⁰Ibid., p. 13.

Agency, and the Office of the Secretary of Defense. Its primary purpose was to determine the feasibility of applying statistical methods to the measurement of unbilled performance and, if feasible, develop the appropriate statistical estimating techniques. It was intended that the statistical procedures be prepared for testing and implementation by September 1969.²¹

The Special Study Group considered four cases of constructive delivery. In Case I, the base case, constructive delivery was defined as occurring at the point in time when the government receives evidence of performance from the contractor. Expenditures would be recorded when a billing document is received, no unbilled performance would be included, and the results would be comparable with the present DOD document-on-hand accrual accounting system. In Case II, constructive delivery was defined as occurring at the point in time when the prime contractor issues evidence of performance to the government. Government expenditures would include the first increment of unbilled performance in the amount of a "document float." The "document float" being billing documents issued by the prime contractor not received by the government at the end of the month.

In Case III, constructive delivery was defined as occurring when the prime contractor accrues earnings to the government account. Government expenditures would include first and second increments of unbilled performance in the amount of "document float" (Case II) plus prime contractor costs incurred, and related profit

²¹U.S., Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain E.E.R. Kinnear, director (Washington, D.C.: Department of the Navy, 1969), p. 4.

and fees, not yet billed to the government. In Case IV, constructive delivery was defined as occurring when the subcontractor and prime contractor accrue earnings to the government account. Government expenditures would include first, second, and third increments of unbilled performance in the amount of the "document float" (Case II) plus prime contractor costs incurred (Case III) and subcontractor costs incurred, and related profit and fees, not yet billed.²²

Cases I and II most closely parallel conventional accounting principles used by private business. In Case I, an accrual would be recognized when a billing document is received. The unbilled performance would be considered. In Case II, an accrual would be recognized when a billing document is issued. In addition to performance reflected on billing documents received, accrued expenditures would include estimates of the amount of performance reflected on billing documents in transit between the contractor and the government at the end of the month. Many private businesses record accruals on this basis monthly and all do this at year-end in order to reflect the proper liability position on the balance sheet.²³

Cases III and IV deviate significantly from private accounting principles. In Case III, an accrual would be recognized when the prime contractor incurs costs or accrues earnings against a government contract and prior to the issuance of a bill to the government. In Case IV an accrual would be recognized when both the prime and subcontractors incur costs or accrues earnings. Case IV most nearly accrues an

²²Ibid., pp. 5-6.

²³Ibid., pp. 6-7.

expenditure in the government's accounts at the time program costs are incurred by contractors and at the time government activity impacts on the private economy. But Cases III and IV require the government to accrue a liability before the prime contractor has issued a bill to the government, and Case IV would require the government to accrue a liability before the subcontractor issues a bill to the prime contractor.²⁴

Analyzing the cases described above, the Special Study Group proposed that a refined and standardized document-on-hand system be implemented to satisfy Cases I and II. The document-on-hand concept will be discussed later in this chapter. Statistical estimators would be necessary to implement Cases III and IV.²⁵ The statistical approach is discussed below.

Statistical Concept

It was determined that a number of different estimating procedures should be researched. These varied from the development of single ratios to be applied at the individual DOD disbursing offices on a contract-by-contract basis to complicated mathematical equations applied to all appropriations on a composite basis at the DOD level. It was considered that all levels of application would have to be tested to arrive at an optimum solution in respect to the costs incurred and the benefits received.

²⁴Ibid., p. 7.

²⁵Ibid., p. 23.

Two statistical estimating procedures were thoroughly developed. One of the procedures was developed primarily by Dr. Herbert Winokur, Office of the Assistant Secretary of Defense (Comptroller), and the other approach was developed primarily by Dr. Leonard Tashman, Office of the Assistant Secretary of Defense (Systems Analysis).²⁶

For the purposes of this paper, the methods by which Doctors Winokur and Tashman estimated performance is not important. Suffice it to say that statistical procedures have been developed for the estimation of defense contractor constructive delivery. The two procedures mentioned above hold the greatest promise for estimating constructive delivery on the basis of such contract characteristics as size of contract, size of invoice, contract pricing provision, frequency of billing, and age of contract. These procedures are currently being tested and preliminary results indicate significant refinement is required but that valid estimators can be constructed.²⁷

Finally, it has not been determined at what level within the DOD accounting/disbursing claim the statistical estimators of constructive delivery should be applied. The best, and in some cases only, source of contract information exists at the field level. Yet, the accuracy of the statistical procedures is greatly improved at a much higher level of aggregation. Similarly, the higher the level of aggregation, the lower the cost of implementation and operation. The optimum level of implementation will

²⁶Ibid., p. 96.

²⁷Ibid., pp. 126-127.

be determined after the firm data requirements for the estimating models have been established and the costs of implementing the models at different levels of detail is better known.²⁸ Once implemented, a mathematical approach appears advantageous from the standpoint of simplicity, economy, and timeliness.

Document-On-Hand Concept

Cases I and II can be implemented using the document-on-hand concept. Some modification is necessary, however. An alternative method suggested to better state the government's liabilities was an expanded document-on-hand system.

Currently, billing procedures vary according to the type of contracts and contractual provisions. For fixed-price contracts with progress payment provisions, contractors are reimbursed in two stages. First, as costs are incurred and prior to delivery, a contractor periodically submits a Contractor's Request for Progress Payment stating the total eligible cost incurred to date and is reimbursed up to a stated per cent of the costs (up to holdback percentage). Subsequently, as partial deliveries are made and the contract is completed the disbursing office liquidates the balance of the invoice. For fixed-price contracts without progress payments, the contractor is paid for partial deliveries or upon completion of the contract.

Of all the media by which contractors' costs are reported to DOD, billing documents, including invoices and progress payment requests, are the best source of

²⁸Ibid., pp. 127-128.

unbilled performance.²⁹ However, not all incurred costs as of the billing dates are included and delays in their receipts do not allow timely estimating and reporting.

To offset these weaknesses, an expanded document-on-hand concept with a separate supplemental reporting system has been developed within the DOD. Based upon billing documents subsequently received, the amount of unbilled performance as of the end of the prior month would be developed. This amount, then, would be reported as supplemental information to the previously submitted financial reports.

This concept was tested by the Interagency Study Group over a two month period. Computed liability was identified by the dates billing documents were received by disbursing offices. Using this information it was determined how soon additional liability data would be available to the disbursing offices after the accounting period. The following tabulation shows the summary result of this analysis.³⁰

Total Computed Liability

Total Liability	<u>Jan 31</u>		<u>Feb 29</u>	
<u>Data Available At:</u>	<u>Amount*</u>	<u>Percent to Total</u>	<u>Amount*</u>	<u>Percent to Total</u>
Month end	\$1,388	81	\$1,375	81
5 days after month end	1,458	86	1,481	87
10 days after month end	1,509	89	1,519	89
20 days after month end	1,576	92	1,606	94
30 days after month end	1,640	96	1,654	97
Over 30 days after month end	1,704	100	1,705	100

*In millions of dollars

²⁹Interagency Study Group, Report of the Interagency Study Group on Contractor Reporting for Purposes of Federal Accounting and Reporting of Accrued Expenditures (Washington, D.C., 1968), p. 42.

³⁰Ibid., p. 43.

As shown on the preceding page, only 81 per cent of the total computed liability would be recorded if all documents on hand at month end are considered. Five days later the per cent would rise to 87, and twenty days later the per cent would increase to the vicinity of 94. Depending upon the due date established for the supplemental information, the preceding tabulation indicates the extent of liability which would be available based upon the expended document-on-hand concept.

Advantages of this method would be that more realistic unbilled performance data could be developed, current billing documents could be used, additional reporting requirements or changes to the accounting system need not be imposed upon contractors, and a minimum of changes are needed in the DOD. The disadvantages are that a supplemental reporting procedure must be designed all the way up to and including Treasury, and not all billing documents include all costs incurred. If certain billing documents were redesigned to capture all other costs incurred, they would provide more timely or just as timely information on unbilled performance as any other method except perhaps the use of a mathematical approach.³¹

Status in DOD

Using the interim procedures as set forth by DOD Instruction 7220.27 and while waiting for a final system to be developed, the three services and the Defense Supply

³¹Ibid., p. 44.

Agency are in various stages of implementation. In toto, as of the end of fiscal year 1969, the Department of Defense had established accrual accounting procedures for the following appropriations, using the document-on-hand concept:³²

Operation and Maintenance

Research, Development, Test, and Evaluation

Military Construction

Stock Funds

Industrial Funds

Prior to June 30, 1969 the DOD did not account for accrued expenditures in the procurement and military personnel appropriations, with the exception of the Air Force. The Air Force has partially implemented a system for accrued expenditures in these two appropriations. Interim procedures were established to place the procurement appropriations on an accrual basis beginning with fiscal 1969 year-end reports. Complete accrual accounting for all military personnel appropriations should be implemented upon the installation of the Joint Uniform Military Pay System (JUMPS).³³ A brief look at the status of service and Defense Supply Agency progress on the implementation of the accrual concepts in the procurement appropriation follows.

³²U.S., Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain G.E.R. Kinnear, director (Washington, D.C.: Department of the Navy, 1969), p. 155.

³³Ibid., p. 156.

o Air Force

The Air Force expenditure accounting system for the procurement appropriation is to a large extent centralized. The bulk of the Air Force procurement appropriations is managed by the Logistics Command, its five Air Material Areas, and fourteen divisions/centers. Payments against Air Force contracts are largely handled by Plant Representative Offices. The expenditures accounting system is mechanized to the extent of preparing a data card on accrued expenditures prior to the time the document is processed for payment. Beginning with the accounting period starting July 1, 1969, the Air Force has submitted accrued expenditure reports for the procurement appropriations on a documented basis.³⁴

Two problem areas exist in the Air Force accounting system for the procurement appropriations. First, they have problems meeting reporting deadlines. Second, the Air Force has not yet decided how applicable fees and profit are to be computed as they may be included in the accrued expenditures report.³⁵

o Army

The Army issued Circular No. 37-52 on July 8, 1969 which implemented an interim accrual accounting system for the procurement appropriations. This Circular provides guidance covering the accounting and reporting of accrued expenditures and covers all appropriations.

³⁴Ibid., p. 160.

³⁵Ibid., p. 160.

The procurement appropriations accounting is designed to provide considerable management information as well as meet the financial reporting requirements of DOD Instruction 7220.27.

Although Army Circular 37-52 meets all requirements leveled by DOD Instruction 7220.27 to fully implement a document-on-hand accrual accounting system for all appropriations, the Army will not have accrual accounting fully implemented for the procurement appropriations until June 30, 1970. A second problem area is that the Army has not yet designed a practicable method for computation of the fees and profits relating to procurement contracts.³⁶

○ Navy

The Navy accounting system for the procurement appropriation is organizationally and physically separated from the major disbursing activities. This separation of disbursing and accounting places a significant extra step in the reporting of expenditure data that is not present in other services. Later in the paper it will be demonstrated how this is probably the Navy's most significant problem in the implementation of accrual accounting.

The Navy implemented an interim system for reporting accrued expenditures on July 1, 1969. It is not a fully document-on-hand system, however, because of the accounting procedures and the lack of automation in processing expenditures for the

³⁶Ibid., pp. 161-162.

procurement appropriations, the Navy has established a method to estimate the value of unpaid documents on hand at the Regional Finance Centers at the end of each month.³⁷ The system will be discussed in Chapter V.

- Defense Supply Agency

The Defense Contract Administration Services Regions subordinate organizations of the Defense Supply Agency, play a large role in the accounting for accrued expenditures for the procurement appropriations. Current procedures call for the DCASR's to report disbursements, holdbacks, progress payments, and documents on-hand but unpaid to each of the military services. This Accrued Expenditure Report is sent monthly to the highest financial level of the service involved where it is integrated with other reports received from field activities. Here a problem exists. The Accrued Expenditure Report prepared by a DCASR could duplicate financial data already in the books of the responsible financial agency. Discussion on this was presented earlier in the chapter.

³⁷Ibid., p. 163.

CHAPTER V

DEPARTMENT OF THE NAVY POSITION

ON ACCRUAL ACCOUNTING

Background

On March 3, 1968, Deputy Secretary of Defense David Packard enjoined the Secretaries of the Military Departments to "devote their personal attention and support in achieving full compliance with the concept of accrual accounting without delay."¹ This was followed by a project charter to the Navy Comptroller from the Assistant Secretary of the Navy (Financial Management) Charles A. Bowsher which directed that the Comptroller:²

1. Design and test a Navy-wide accounting and reporting system in terms of generally accepted accrual accounting principles, and integrated with accounting for obligations, disbursements, and liabilities in a single, coordinated system.

¹U.S., Department of Defense, Secretary of Defense, Memorandum for Secretaries of the Military Departments and Directors of Defense Agencies, March 3, 1968, Washington, D.C.

²U.S., Department of the Navy, Office of the Assistant Secretary of the Navy, (Financial Management), Project Charter for Accrual Accounting, July 1, 1968, Washington, D.C.

2. Prepare a system design to comply with BOB Bulletins, GAO policies, principles and procedures, and OSD directives.
3. Correlate budget formulation and execution phases to provide valid comparisons between planned and actual performance.
4. Identify current practices superseded by introduction of accrued accounting.
5. Propose a time-phase implementation plan.

In March 1969, the Assistant Secretary of the Navy (Financial Management) advised the Assistant Secretary of Defense (Comptroller) that the Navy would have in operation a system of accrual accounting covering documented (in accordance with DOD Instruction 7220.27) transactions for all appropriations, except procurement. He further explained that an interim system would be necessary for the procurement appropriations pending major substantive changes to permit integration of accrual data into the general appropriation accounting system. He concluded by saying that certain significant refinements in establishing accruals for military pay appropriations must await implementation of the Joint Uniform Military Pay System (JUMPS).³

JUMPS is an accrual accounting system that will provide managers with information on military personnel costs. The system is designed for quick response. Currently there is up to a nine month delay in collecting, recording, and transposing

³U.S. , Department of the Navy, Office of the Assistant Secretary of the Navy (Financial Management), Memorandum to the Assistant Secretary of Defense (Comptroller), March 17, 1969, Washington, D.C.

the dollars paid to Navy men from pay records to financial reports. As a result, in fiscal year 1968 there was an over-obligation in the appropriation Military Pay, Navy.⁴ With JUMPS operational all pay records will be maintained at a control source, on a computer at the Navy Finance Center, Cleveland, Ohio. Response will be immediate, hence monthly accruals will be accurate.

JUMPS is not without problems however. First, a formidable programming problem is in the offing. Not having adequate in-house expertise in this area and faced with a promise of tight funding, this will continue to provide hardships. Second, JUMPS must interface with the Bureau of Naval Personnel's Management Information System. To date, the Bureau of Naval Personnel has not been funded to accomplish their end of the interface.⁵ Third, the matter of responsiveness is a matter of responsiveness is a matter of utmost concern. JUMPS will ultimately communicate with ships and stations through electronic data lines but at the outset documents will flow to and from Cleveland via air mail. Those working in the JUMPS project are acutely aware of these problems and are striving to overcome these prior to the planned JUMPS implementation date of July 1, 1971. This appears to be an extremely optimistic forecast.

⁴Commander W.H. Johnson, SC, USN, JUMPS Planning Group, Navy Finance Center, Cleveland, Ohio, telephone interview held on November 6, 1969.

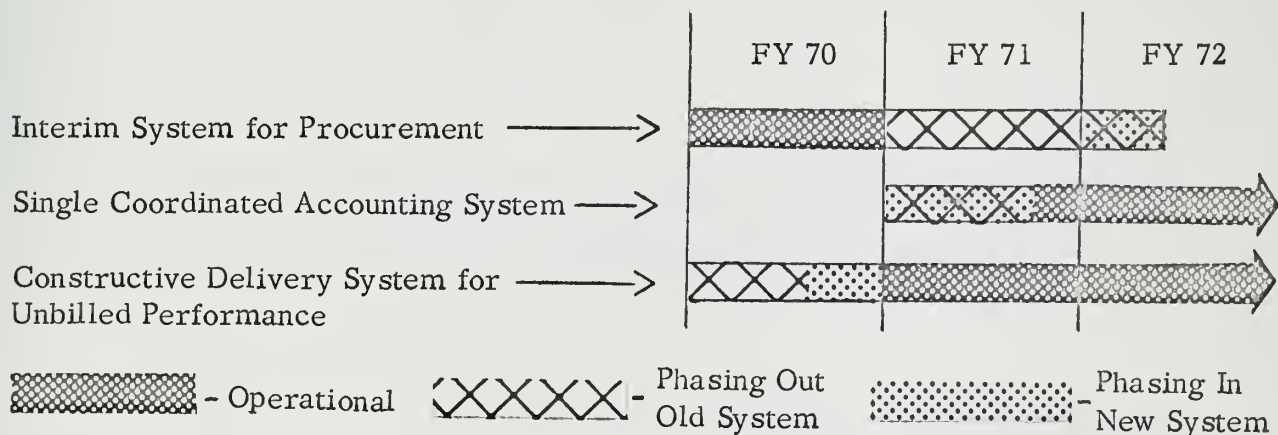
⁵U.S., Department of the Navy, Financial Management Systems Steering/Evaluation Group, Report of the 30 July 1969 Meeting (Washington, D.C., 1969), p. 67.

Implementation

The implementation schedule for the Navy's accrual accounting conversion of the procurement appropriation is shown in Figure 3.⁶ The implementation shown indicates that the interim system for the procurement appropriation will continue until: (1) a single coordinated system for capturing billed costs for all appropriations is developed, and (2) a constructive delivery system for capturing unbilled performance in the procurement appropriations is developed. The single coordinated accounting system refers to the Navy-wide Uniform General Ledger Account Structure mentioned earlier and will be further discussed later in this paper. The road leading to implementation is fraught with problems however.

FIGURE 3
IMPLEMENTATION SCHEDULE

Governing Deadline: FY 72 President's Budget prepared in fall 1970 must show accrued expenditures for FY 70, 71, & 72.



⁶ibid., p. 84.

Problems

Having discussed the problems facing the Department of Defense, suffice it to say that the Navy is having these same problems and some peculiar to itself.

It can safely be said that understanding the principles of accrual accounting is lacking throughout the Department of Defense. In developing this point an analysis will be made of a study developed by the Navy in response to a DOD directive.

A memorandum from the Assistant Secretary of Defense (Comptroller) to the Assistant Secretaries of the Military Departments (Financial Managers) and the Director of the Defense Supply Agency precipitated the study.⁷ The memorandum suggested that a cut-off point could be determined whereby contracts under an established floor would be treated as expenses at the time of obligation. Services were to select representative installations, as many as practicable but a minimum of twenty from each service and DSA. The following information was requested for each contract selected:

1. Date of initial obligation;
2. Amount of initial obligation;
3. Date(s) and amount(s) of any obligation adjustment(s); and
4. Date(s) and amount(s) of deliveries against the contracts.

⁷U.S., Department of Defense, Assistant Secretary of Defense (Comptroller), Memorandum for Assistant Secretaries of the Military Departments (Financial Managers) and Director of the Defense Supply Agency, July 7, 1969, Washington, D.C.

Pending the outcome of this study, DOD planned to advise the Bureau of the Budget, and the General Accounting Office that they proposed to authorize DOD components, on an interim basis, to simultaneously obligate and expense contracts and orders that are \$10,000 and under and are financed under operation and maintenance appropriations.⁸

This memorandum precipitated Navy Comptroller Notice 7042 dated August 7, 1969. The information required at the DOD level was collected and examined by the Navy. It was determined from this sample that 96.3 per cent of the contracts were for under \$10,000 and this represented 24 per cent of the value of the total contracts sampled.⁹ Outside of verifying Pareto's law, no further use has been made of the information to the knowledge of the writer.

However, the implication that a problem of understanding exists is evident. While it can be seen that DOD is interested in reducing the workload anticipated under the accrual concept, a violation of the accrual principle would result. While the materiality principle would not be violated for one or even 100 contracts under \$10,000, consider the impact of 10,000 or 50,000 of such contracts. The question of performance is a necessary adjunct in the accrual process.

As mentioned in Chapter IV, the Navy accounting system for the procurement appropriation is organizationally and physically separated from the major disbursing

⁸Ibid., p. 2.

⁹John Nuck, Office of the Navy Comptroller, private interview held at the Navy Comptroller's Headquarters on November 4, 1969.

activities which consist of ten Regional Finance Centers (including the Marine Corps Finance Center). Further, the Navy is different from the other services in that most "big money" procurement is accomplished by the System Commander and Headquarters Marine Corps. However, there are seventy other Navy and Marine Corps organizations around the world which obligate relatively small amounts of the procurement funds.¹⁰

This separation of disbursing and accounting for Navy procurement appropriations places a significant extra step in the reporting of expenditure data. To further complicate the flow of expenditure data, some of the Regional Finance Centers have subordinate Disbursing Accounting Branch (DAB) offices co-located with the Navy Plant Representative office at the larger defense contractors. These DAB's perform memorandum accounting on individual contracts, pay bills rendered by the contract, and report expenditure information to their parent regional finance center.¹¹ This separation of accounting and disbursing activities is one of the major problems facing the Navy today in its efforts to install accrual accounting in the procurement appropriation.

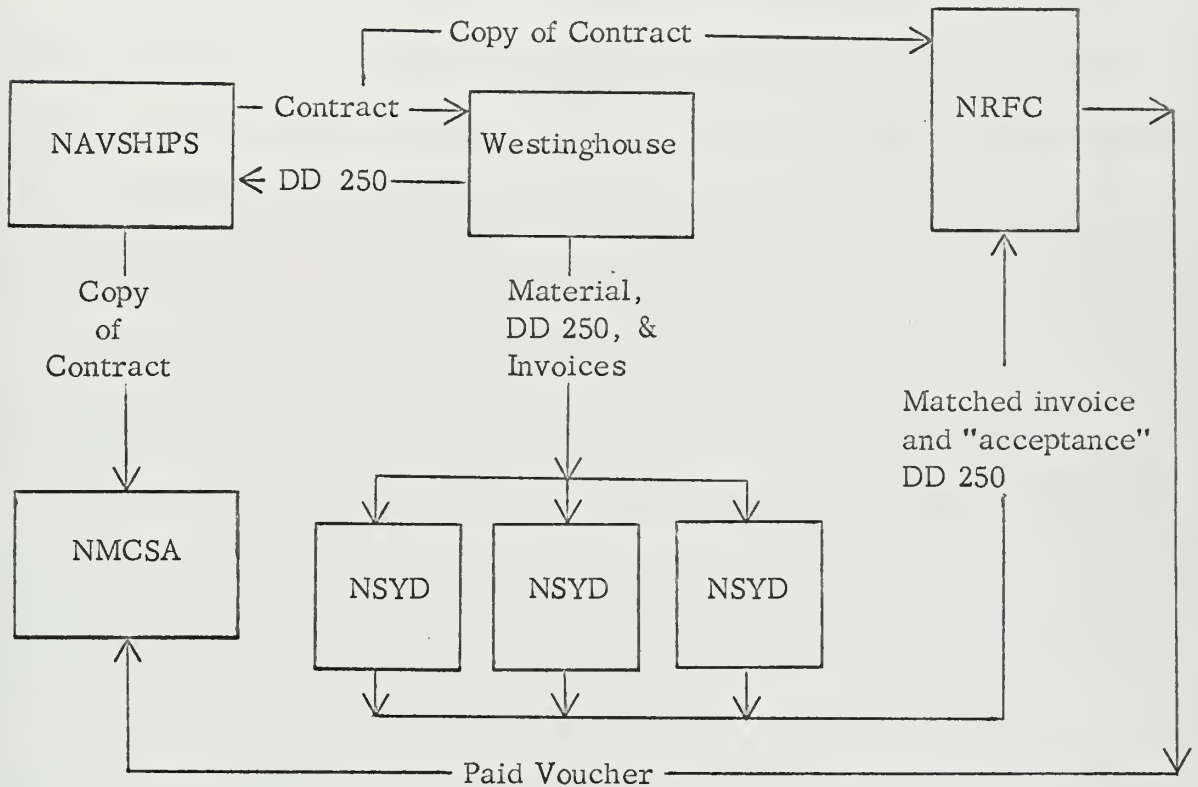
An example of this problem is offered for clarification. Refer to Figure 4 in following the explanation.

The Naval Ships Systems Command (NAVSHIPS), the purchasing activity,

¹⁰U.S., Department of the Navy, Report of the DOD Special Study Group on Defense Contractor Constructive Delivery, Captain G.E.R. Kinnear, director (Washington, D.C.: Department of the Navy, 1969), p. 162.

¹¹Ibid., p. 163.

FIGURE 4
EXAMPLE OF ACCOUNTING AND DISBURSING
SEPARATION PROBLEM



determined that a new radar is required for a certain class ship. The radar equipment is to be manufactured by Westinghouse, shipped to various Naval Shipyards (NSYD) for installation on these ships, and paid for by a Navy Regional Finance Center (NRFC). The Naval Material Command Support Activity (NMCSA) performs all accounting functions for NAVSHIPS.

NAVSHIPS, the purchasing office, contracts with Westinghouse for the radar

equipment and sends a copy of this to the NMCSA for obligational purposes and to the NRFC which will make payment. The contract directs Westinghouse to manufacture the equipment and ship it to specified naval shipyards.

Upon manufacture of the radar equipment, Westinghouse ships them to the consignee (shipyards) accompanied by a Material Inspection and Receiving Report (DD Form 250) and an invoice. A notification of shipment is made to the purchasing activity, NAVSHIPS, by a copy of the DD 250 sent to the shipyards. However, a DD Form 250 is not sent to the accounting activity, NMCSA. The invoice accompanying the radar equipment to the shipyard contains no accounting data since the shipyard has no knowledge of what activity is performing the accounting for the transaction.

The shipyards certify acceptance of the equipment on the DD Form 250 and forward it, along with the invoice, to the NRFC for payment. The NRFC, by matching against a copy of the contract, determines that NMCSA is the accounting activity and accordingly, sends NMCSA a copy of the paid voucher. However, by the time the payment is made and the paid voucher sent to NMCSA, a period of time has elapsed. In this example, the accrual is not based upon performance by Westinghouse but by payment by the NRFC, which is much later. As a result, a past accrual report was understated and the one containing the radar equipment is overstated.

There are four possible solutions to the problem described above. First, the Armed Services Procurement Regulations (ASPR) which govern transactions such as the one above, could be changed to require the contractor to send a copy of the DD

Form 250 to the accounting activity. However, since the Navy is the only service having separate accounting and paying activities, there is reluctance in doing this. ASPR officials maintain that short of combining accounting and paying activities, enough copies of the DD Form 250 are available and it is up to the Navy to solve their own problem. Second, since a copy of all contracts are sent to the NRFC, have them perform accounting as well as paying functions. Third, assign a disbursing officer to activities that perform accounting for systems commands and have these activities pay as well as maintain accounting. Fourth, direct contractors to send the invoice to the accounting activity in lieu of the consignee. Continue to send the DD Form 250 to the consignee, who would certify acceptance of the material, and would send the "accepted" DD Form 250 to the accounting activity. The accrual would be recognized at this point in time. After matching the invoice with the DD Form 250, together these documents would be forwarded to the NRFC for payment.

There are other problems facing the Navy in designing their accrual accounting systems. Generally these are a lack of resources, both financial and personnel, lack of skills on the part of personnel, and inadequate ADP equipment. Besides the need for ADP equipment there is a tremendous need for programming and re-programming. Training not only for accountants and clerks is required but also for managers who must administer the system. As for lack of resources, more specifically funding, the Navy as an agency of DOD is faced with the problem of

acquiring this funding from Congress to fully implement the system. Congress, which is divided in this appraisal of accrual accounting will have to be convinced of the returns that can be expected in return for a requested outlay. With the austere funding climate of today this can be a preplexing problem.

In summary, the Navy is faced with problems of understanding, procedures, and resources, all superimposed against a constraint of time. The remainder of this chapter will deal with the progress being made in the Navy to overcome these problems.

Progress

The Navy has taken definite strides towards installing the accrual concept. In taking an inventory of their progress, the following appropriations are on the accrual basis:

- . Industrial Funds,
- . Navy and Marine Corps Stock Funds,
- . Military Construction,
- . Operations and Maintenance (PRIME), and
- . Research, Development, Test, and Evaluation.

An interim system for the procurement appropriations went on-line on July 1, 1969.

The Navy has also developed a Navy-wide uniform general ledger account

structure. This master chart of general ledger accounts prescribes a comprehensive list of control accounts that are uniform in definition and codification. The design of the master chart of accounts conforms with the principles and policies of the General Accounting Office and reporting requirements of the Office of the Secretary of Defense and the Secretary of the Navy.¹² This uniformity affords greater opportunity to prescribe uniform methods and procedures in accounting and reporting for all appropriations.

A test of the uniform general ledger account structure was conducted in the Chief of Naval Air Basic Training Command. This was a simulated test wherein a set of books were set up after converting the March 1969 month-end balances to the new ledger format. The test, from April to July 1969, resulted in some changes to the newly devised structure and proved successful.¹³

As mentioned earlier, an interim system for the procurement appropriations was put into effect. Only the Navy Regional Finance Centers and the Defense Contract Administration Services Regions (DCASR's) are involved in this interim system. The idea here being that the interim system should effect the Navy overall in the least.

If the Federal budget is to be on an accrued expenditure basis for fiscal year

¹²U.S., Department of the Navy, Office of the Comptroller, Navy-Wide Uniform General Ledger Account Structure (NAVSO P-3064), March 7, 1969, Washington, D.C., pp. 2-3.

¹³U.S., Department of the Navy, Financial Management Systems Steering/Evaluation Group, Report of the 30 July 1969 Meeting (Washington, D.C., 1969), pp. 80-85.

1972, a phase-in period will be necessary. Hence, the interim system for reporting accruals was conceptualized and put into effect at the NRFC's and DCASR's on July 1, 1969. Navy Comptroller and Defense Supply Agency instructions prescribed the method of accumulating and reporting accrued expenditures. Simply, unpaid documents for the procurement appropriations that are backlogged at these offices at the end of each month, including requests for progress payments, are summarized by appropriation and the dollar value is reported to the Navy Comptroller. The Navy Comptroller reports this information to the Treasury where an adjustment is made for the month in question and the true impact of the economy is determined. In an effort to ease the workload on NRFC's the DCASR concept has had much emphasis placed upon it. The DCASR's are employed as paying activities for some of those contracts where the goods are inspected at the contractor's plant. The NRFC's make payment based upon receipt of a signed acceptance document certifying that goods or services have been received and accepted. This decentralization of activity has resulted in a smaller backlog of unpaid invoices. For example, whereas the Navy Regional Finance Center, Norfolk, Virginia previously processed 43,000 contracts for payment annually, they now process 28,000. The remaining 15,000 are processed by the DCASR's.¹⁴

The Navy Stock Fund has been on the accrual basis since 1963. That is, material

¹⁴Captain J.H. Sherman, Jr., SC, USN, Commanding Officer, Navy Regional Finance Center, Norfolk, Virginia, private interview held in Norfolk, Virginia on November 28, 1969.

input to the fund has been on the accrual basis since 1963. The Navy Stock Fund is a revolving fund and is financed through its sale of material to defense activities, its sales are its outputs.

To put the users of the Navy Stock Fund on an accrual basis, the Navy promulgated Navy Comptroller Notice 7302 dated January 21, 1969. This instruction defined new concepts regarding the obligation and issue of stock fund material. Effective April 1, 1969, material dropped from inventory, that is, issued out of the Navy Stock Fund and ready for delivery, is charged to that customer's funds. The drop from inventory (performance) and the charge to the customer's funds (expenditure) occur simultaneously and the accrual is recorded. If the activity receiving the requisition from the customer cannot satisfy the request from stocks on hand, due in, or by referring the requisition to another Navy or Marine Corps activity, procurement action will be taken. Nearly all material in the Navy Stock Fund is off-the-shelf type material, i.e., commercial items which are normally available from inventory for either defense or non-defense work. Hence, when procurement action is taken for off-the-shelf items, almost immediate billing occurs and the accruals are easily recorded.

To purify the outstanding requisition files of accounting activities, on April 1, 1969, outstanding requisitions were deobligated and maintained on memorandum records. This did not include afloat and other selected activities. As the material was received by the stock point and "dropped" to the requisitioner, the requisition

was removed from the memorandum file, and simultaneously obligated and expensed. Thus, these requisitions were "reconstructed" into accruals.¹⁵

The Navy is rushing an all-out effort to implement a single coordinated system of accrual accounting in the procurement area prior to fiscal year 1972 budget preparation. Currently, the document-on-hand concept is being refined for measuring billed performance. In the area of unbilled performance, the Defense Contractor Constructive Delivery Group, under Navy direction, is developing a statistical approach that will satisfy the requirements of Bureau of the Budget Bulletin 68-10 and the central fiscal agencies. This approach also incorporates that feature of accrual accounting which will measure the impact of government spending on the private economy.¹⁶

¹⁵U.S. , Department of the Navy, Office of the Comptroller, "Obligations For Materials To Be Delivered From Stock Fund Inventories," (NAVCOMPT NOTICE 7302), January 21, 1969, pp. 2-3.

¹⁶U.S. , Department of the Navy, Financial Management Systems Steering/ Evaluation Group, Report of the 30 July Meeting (Washington, D.C., 1969), pp. 80-85.

CHAPTER VI

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The Federal use of accrual accounting does not fully meet the generally accepted methods of accounting in private industry. In private industry, the accrual basis associates all income and expenses to an accounting period. Accounting in the government does not fully recognize all expenses since capital assets are generally not depreciated. The President's Commission on Budget Concepts recognized this and did not recommend across-the-board accounting for depreciation. Further, in industry, accounting for the unbilled cost of vendors is not required. This is a recommendation of the President's Commission on Budget Concepts and it was given strong emphasis by Bureau of the Budget Bulletin No. 68-10. Thus, accrual accounting in government has at least two significant differences from private accounting.

Understanding the meaning and concepts of accrual accounting is a serious problem. This problem exists in all aspects of government, including the Congress. Congress is divided in its opinion of accrual accounting. While the House Government Operations Committee, which has cognizance over accounting systems, completely

endorses the concept, the House Appropriations Committee does not. For a committee as powerful as the House Appropriations to mount opposition against this concept means problems, especially when one considers that money bills normally originate there. Money has influence. How the House Appropriations Committee chooses to use this influence remains to be seen.

Faced with the precepts recommended by the President's Commission and directed by Bulletin 68-10, the government, and for the purposes of this paper, the Department of Defense, has the responsibility to implement them. The most difficult and potentially most costly aspect of conversion to accrual accounting in the Department of Defense is the unbilled performance requirement. The unbilled performance requirements set forth in Bulletin 68-10 are considered to exceed the recommendations of the President's Commission. It is not readily apparent that the President's Commission intended constructive delivery to mean unbilled performance, particularly subcontractor unbilled performance. Some of the objectives established by the President's Commission, particularly the structuring of better economic indicators of government economic impact, require some measure of unbilled performance. However, no potential users of this information have justified expenditure of the millions of dollars annually required to collect all levels of unbilled performance data through the accounting system and to report this information in the Department of Defense budget.

Regardless of the intent of the President's Commission, unbilled performance is

a reality and must be reckoned with. In view of the staggering number of contracts, contractors, government disbursing and accounting offices, and reporting requirements, and the variety of reporting channels and contract administration arrangements in the Department of Defense, the recording and reporting system to be developed should be simple, as economical as possible, and should impose minimal impact on current government as well as contractor operations and accounting systems. It should be recognized that any practical and reliable method to capture unbilled performance will be expensive and will require considerable time and effort for implementation.

Progress in developing an acceptable system is being made. The development of statistical estimators for unbilled performance is feasible and is underway. One of the statistical estimators is based upon an investigation of lags between the time a prime contractor records costs to the government account and the time the government receives an invoice for these costs. The assumption underlying this approach is that the dollar value of the contractor's unbilled performance is directly proportional to the length of the pipeline (time lag).

A second statistical estimator being investigated takes essentially the same form except that it bypasses the investigation of time lags and attempts to relate contractor unbilled performance directly to contract values. Each of the approaches considers basically the same contract characteristics, therefore, if either statistical estimator is successful, the other is likely to produce acceptable results.

There has been an explosion of new mathematical techniques for forecasting, searching for solutions to management problems, and assisting in the decision-making process. Hence, the application of a statistical approach or a mathematical model for estimating the amounts of unbilled performance cannot be ruled out. Once implemented, a mathematical approach should be simple and economical.

Unbilled performance could be measured through an expended-document-on-hand accrual accounting system. Although an expended-document-on-hand system could be accomplished in several ways, the essential ingredient is the screening of documents received subsequent to the end of the accounting period to develop the value of unbilled performance on documents issued and dated prior to the end of the accounting period. While the accrual is not recorded instantaneously it nonetheless is recorded at some subsequent time. By requiring contractors to indicate the precise period of performance on all billing documents, the expended document-on-hand system can also be used to validate the statistical estimating systems. The advantages of this system are that realistic unbilled performance could be developed, currently billed documents could be used, and a minimum of changes to existing Department of Defense procedures would be required.

Another measure of unbilled performance could be made by using the pure, precision method of measurement whereby all costs are recorded almost instantaneously and reported to the government. The value of this method is beyond question, however, the practicality and wisdom of attempting to achieve this is the issue. Such

a massive undertaking appears to be both costly and unwieldy. The goal to develop the ultimate measure of performance is unreasonable and probably not attainable.

At present the Navy does not fully meet the concepts called for in Bulletin 68-10. They have successfully implemented appropriations dealing with Industrial Funds; Navy and Marine Corps Stock Funds; Military Construction; Operations and Maintenance; and Research, Development, Test, and Evaluation. Partial success has been accomplished in the Military Personnel appropriation and full success is expected when the Joint Uniform Military Pay System becomes operational. With JUMPS on line and the interim procurement appropriation phased into the final product, the Navy will meet the concepts of accrual accounting as planned to be practiced in government.

In conclusion, it is expected that the Navy will "technically" meet the requirements of accrual accounting in time for the 1972 budget preparation. Technically in the sense that the Navy will officially be "on line" but they will be working with arbitrary guidelines and the expertise in applying the concepts will be minimal. In time, as experience is gained and refinements are made, the Navy will have the ability to apply the concepts of accrual accounting as set forth in Bulletin 68-10.

It is further concluded that defense constructive delivery information is an absolutely essential element in examining the impacts of defense spending on the national economy. It is especially important in times of rapid arms buildup and reduction when defense spending is a major influence on employment, gross national

product, and price levels, and when monetary and fiscal policies must be responsive to avert either recession or inflation.

Recommendations

In applying the constructive delivery concept to accrual accounting several recommendations on methodology are offered for consideration.

A new reporting system for contractors would be expensive and time consuming. To develop a new system, the Department of Defense would indirectly pay for its installation through increased contract costs. Considering the huge number of contracts involved and a report for each appropriation, the processing endeavor would be massive.

Recommendation 1:

A new and complete reporting procedure on unbilled performance not be imposed on the contractors.

A positive (precision) reporting system on unbilled performance is not economically feasible. Many contractors do not know and cannot accurately estimate the amount of unbilled and unapplied costs which pertain to a certain contract.

Recommendation 2:

A positive (precision) reporting system on unbilled performance not be implemented in the Department of Defense.

An incremental approach in applying the cases should be used. For example, if Case I information, i.e., the document-on-hand system, were used, data would be

available. By applying each case sequentially, the costs of each incremental improvement can be weighed against the benefits obtained.

Recommendation 3:

The level of detail, accuracy, and comprehensiveness to be used should be determined by weighing the benefits of each increment of information against the cost of obtaining these increments.

The document-on-hand system when refined and standardized, will simplify the problems of estimating constructive delivery. It will provide a means superior to the cash basis for determining the defense economic impact and will make the government's accounts more consistent with those of private business.

Recommendation 4:

The document-on-hand system (Case I) be refined and standardized to record all performance reflected on billing documents.

There is a problem of contractor's invoices reflecting performance that overlaps from one month to another. This problem can be obviated if contractors will show the period of performance on the invoice.

Recommendation 5:

All contractor billings should be required to indicate the dates of performance for the work billed.

When the document-on-hand system is standardized, methods to better state the government's liability should be considered. The expanded document-on-hand system is one of the methods. Based upon billing documents received subsequent to the end

of the month, the amount of unbilled performance as of the end of the prior month would be developed. This amount would then be reported as supplemental information to the previously submitted reports. In this manner, more realistic unbilled performance data would be generated, current billing documents could be used, additional reporting requirements need not be imposed on the contractor, and a minimum of changes are needed to Department of Defense accounting procedures.

Recommendation 6:

An expanded document-on-hand system (Case II) be designed and adopted which will provide for bills in transit at month-end to be integrated into the Department of Defense accounting system.

A measure of impact on the private economy by defense spending was a major reason why the President's Commission on Budget Concepts recommended the adoption of accrual accounting. A statistical approach is feasible for determining the impact on the economy and the accuracy of this method could subsequently be determined by the results of the expanded document-on-hand system.

Recommendation 7:

A statistical method be designed which is capable of estimating contractor unbilled performance (Case III) for defense procurement appropriations for use by Department of Defense management, central financial agencies, and economists but not for integration into the Department of Defense accounting system.

The statistical methods of determining performance are more economical and less time consuming than the expanded document-on-hand method. However, accuracy

is sacrificed in order to gain these benefits at present. Refinements in the statistical approaches are necessary in order to provide identity between the results of the expanded document-on-hand method and the statistical method.

Recommendation 8:

Use the expanded document-on-hand method as a base. Develop the statistical approach until it provides consistent and similar results over a period of time and then use the statistical method exclusively for both government and private use.

It is concluded that these recommendations are the most feasible and most efficient measure of satisfying the recommendations of the President's Commission on Budget Concepts and the directives of Bulletin 68-10. The accounting system would then be comparable to that of the private sector, more timely data on agency performance would be available, and the impact of defense spending would be discernible to the economists.

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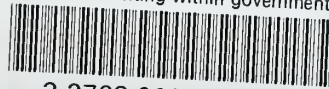
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